BOSTON UNIVERSITY

College of Business Administration

THESIS

Changes in the Basis of Taxation--1929-1936

by

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Introduction

In setting up the foundation for this thesis there are many different directions of explanation that it may take. That is, it is difficult to obtain a coherent form so that there will be a complete picture. The outline as shown is handled in this way because it is thought that by taking the National Recovery Administration period as a basic history there would then be shown the problem of the thesis. After constructing this period we could analyze the budgets through the years from 1931 to 1936, then from the study of these budgets consider the debt policy and its effect. In discussing the various tax measures emphasis is placed upon the principle that only in time of an emergency should a government resort to excessive borrowing. State finance is taken up in only one chapter, although state taxation and expenditures in relation with Federal finance must be given their full importance when thinking of the taxpayer's ability to pay.

The following paragraphs give a brief summary of the entire thesis, and the purpose is perhaps described better than in the foregoing description of the procedure or method which has been used in drawing conclusions. In the way of explanation it may be stated that the undue influence sometimes given to taxation for causing maladjustments may be exaggerated, however, it is realized that there are many

factors entering into such maladjustments.

The fact was before our Federal Government in the Hoover administration that there must be governmental assistance to industry. And in the new election of 1932 there came an era of economic planning. During such an emergency as the administration found itself no thought was given to the object of this planning or what results it would have on our industrial life. As to deficits they were little thought of as a danger. The thought of the day was to spend. Public works construction cure for depressions sounded fool-proof, the main objective was expenditures not income. A study of the budgets shows how determined we were to spend. There were increases in taxes, such as higher income taxes and new excise taxes, but compared to the increased expenditure their proportion was small.

From a period that was slowly paying off a huge debt there came with the depression a reaction that began to increase the size of our national debt again. In each year since 1930 we have had a deficit ranging from 903 million dollars in 1931 to a peak of 4,764 million dollars in 1936. At the close of the fiscal year 1937 our national debt stood at 36,400 million dollars. We have learned that the country can bear a gigantic debt without a sudden catastrophe but we have yet to learn the effects upon our

credit system which has financed our governmental expenditures.

There is a basis for taxation throughout this period, however, it has been played to the usual tune of politics. Social legislation considered that which appealed to the people as voters, our relief measures along with public works and work relief such as W.P.A. and C.W.A. were banners that were never taken down. The legislation of progressive taxes was in line with this program, and the redistribution of the wealth has been an echo that has easily resounded. When we ask if the basis of present taxes is upon an ability to pay or benefits received it is a vague question, it sounds as strange as some out-worn economic doctrine. We can, on the other hand, be satisfied that there is a basis for taxation which rests upon social reform; if not directly it is accomplished indirectly. Taxation as a means of revenue seems at times to be a paradox, the ultimate objective being to restrain activities of individuals or corporations.

It is of interest that we try to see what effect our governmental expenditures will have and upon what reasons our taxation of the future will be built. We realize that capital taken by governments is often not used as effectively as in private enterprise. Our Federal expenditure has gone into many relief measures never to return in the form of wealth. Now in our tax measures upon business are we misdirecting the flow of wealth that will handicap our industry?

Turgot recognized this power of taxation and E.A.R. Seligman puts Turgot's theory in these words--"All wealth may indeed be taken by main force; but no wealth necessary to the work of reproduction can be diverted from this end without injury to the national wealth, and consequently to the power of the government. In the recognition of this principle consists the whole theory of taxation."*

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*E.A.R. Seligman, "The Shifting and Incidence of Taxation", (1926) P. 139.

Chapter 1

Expenditures

ATTITUDE OF GOVERNMENT TOWARD EXPENDITURES FROM 1929 to 1932

The importance of the depression that had just started was not realized, both government and business were slow to take this fact into consideration. People continued to buy even in the face of the recession. The government sought to bring back prosperity by telling business it was only a temporary decline. However unwilling President Hoover was to believe in anything but a recovery he was forced to accept the fact in 1931 and 1932. The national income dwindled from $72,186 million in 1930 to $60,117 million in 1931, and to $46,506 million in 1932.* As production fell off in heavy industries consumption was decreased. Our credit structure was highly inflated and as earnings started to fall liquidation started which encompassed all kinds of investments investments and loans, everything from stocks to the low grade mortgages of our agricultural area.

When the effects were finally seen it was stalemated because of political difficulties. President Hoover stated that it was not the place of government to enter into the aiding of such conditions. He has been called conservative because of his determination for non-interference by the government, but from an opposing view, he may have had the vision to see the inevitable result of taxation for relief, a movement when once started it is very difficult

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*National Industrial Conference Board, "Cost of Government in the United States 1934-1936" (1937) P. 39.

to control. His attitude toward public works is contained in this quotation, "To increase taxation for purposes of construction defeats its own purpose as such taxes directly diminish employment in private industry."* He was consistent in this policy in that his objective was to lend to industry and agriculture but there should be no direct aid (in the case of agriculture it may be considered that there was direct aid or subsidy).

In viewing tax collections in this period, there was no cause for alarm. In 1930 tax collections were at a high point of $3,468 million, the highest since 1922. The criticism that it is the return of part of the year 1929 is justified but even in 1931 there was a return of $2,717 million. Also in comparison with years prior to 1928 it is shown that the taxes were reduced rather than raised in this period before 1933.

From the standpoint of national income and from that of viewing taxation as an indicator of the trend, it was impossible to understand the conditions that prevailed in the United States at that time. These two factors may have caused the government to hesitate in its program, but also the factor of changing administrations held up any progressive action. It can be summarized into the following facts that the attitude of government was due to: ignorance of the situation; the theory of the administration was that prosperity

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*Harry L. Hopkins, "Spending to Save" (1936) P. 25.

is maintained by industry's power to produce; action was delayed by the political dominance of the majority party; and lastly, conditions in foreign countries, which were beyond the control of this country, played a major part in determining some of the policies.

EXPENDITURES--LIQUIDATING OR NON-LIQUIDATING

Up to 1931 the surplus that was accumulated went to retire the government debt. After the budget began to show a deficit the cause was partly due to increased government constructive activity, the extension of loans to agriculture, and also increased loans to veterans. It was believed at the time that the expenditures were only temporary and the loans that were made were supposedly of a self-liquidating nature. For both the fiscal years 1931 and 1932 all of the expenditures were repayable. But for 1933 only three-fourths of the expenditures were repayable; for 1934 $1,649 million was repayable out of total expenditures of $4,002; for 1935 $3,351 million was not repayable; for 1936 $3,311 million was not repayable.*

The federal government at different stages changed its policy of trying to bring about recovery and, therefore, in the earlier part of the depression its theory of aiding business was made in repayable loans. Later as President Roosevelt and Congress saw the significance of our economic decline they realized that direct relief would be necessary.

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*National Industrial Conference Board, "Cost of Government in the United States 1934-1936" (1937) P. 15.

There were many changes in administration and the discussion of the various agencies in the following paragraphs will consider such changes and their effect on the national wealth of the country.

RECONSTRUCTION FINANCE CORPORATION

This corporation was sponsored by the government in order to aid our industrial order. Prior to 1934 all of the emergency expenditures of the federal government were on account of the Reconstruction Finance Corporation. It has been a huge undertaking as a summary of its activities on September 9, 1937 shows. "Authorizations and commitments of the Reconstruction Finance Corporation in the Recovery program to August 21, were $11,967,910,477.87." The original purpose of aiding business was sound and it did its business from a sound banker's standpoint. There is naturally to be expected some loss because of the administration of such a large organization. The loan offices were scattered all over the country which made it difficult to coordinate them. Independent units in themselves, they were responsible to one authority. In spite of all this administration the record is good, out of total disbursements $6,565,878,120.90 there has been $4,780,968,725.56 repaid.*

The other money that has been paid out was not the responsibility of the directors of the Corporation. "The relief disbursements include $299,984,999 advanced directly

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*All of these quotations and figures are taken from a bulletin issued by the Reconstruction Finance Corporation September 9, 1937.

to the states by the Corporation, $499,999,880.89 to the states upon certification of the Federal Relief Administrator, $500,000,000 to the Federal Emergency Relief Administrator under the provisions of the Emergency Appropriation Act--1935, and $500,000,000 under the provisions of the Emergency Relief Appropriation Act--1935." The total for relief being $1,799,984,879.89. Disbursements to other governmental agencies were $899,245,506.11.*

At the beginning of its existence the Corporation dealt only with banks, credit corporations, and insurance companies. As unemployment increased, not only was it the purpose to maintain the going concerns but the problem of employment was seen to be one of the causes as influencing a great business decline. Railroads were then directly dealt with as were other self-liquidating projects. In lending to such projects the purpose was to aid the unemployed. However, the main function of the Reconstruction Finance Corporation was that of a credit agency, and to supply employment was secondary although the latter may have been the end in view.

The operations of this governmental agency along with the open-market purchases in 1932 of the Federal Reserve Banks have been criticized because of their effect on business. "Alexander Sachs expressed the view that the nation had, 'through interference with proper readjustments and

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*Ibid.

misconceived and misguided inflationary and reflationary devices, produced a situation of such unsettlement, doubt and paralysis as to have thrown economic life into a stage where the feudalism, barter, and scrip of ages gone by had become contemporary history."*

There is no doubt of the misdirected funds of the Reconstruction Finance Corporation and it may have had a cushioning effect which lengthened the depression. In spite of committing overt acts of wastefulness, which were foreign and still are in our business economy, the fact was an emergency had to be met. The Reconstruction Finance Corporation was set up to help business and it has filled a place in the economy of the past five years. Now with 73 per cent of its loans repaid it will have a fair record when it is finally liquidated. (It now holds approximately two and a half billion dollars of unrecoverable assets on its balance sheet).**

FARM CREDIT ADMINISTRATION

The history of government in aiding agriculture has been one of continued growth since the depression of 1920. It is true that the expansion of state banks was influenced by agricultural interests during Jackson's administration, then after the Civil War these interests were for the issuance of paper money, and the free silver campaign of

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*Charles Frederick Roos, "N.R.A. Economic Planning". A publication of the Cowles Commission for Research in Economics (1937) P. 7.
**The United States News, December 20, 1937.

1896 was backed by the farmer. Yet these influences were very small compared with the pressure that has been brought to aid the farmer in the last two decades.

In the Federal Reserve Act there was provision for the rediscounting of agricultural paper with a maturity of six months at a Federal Reserve Bank. This was the introduction of what was to follow in 1917 when the Federal Land Bank System was set up under the Federal Farm Loan Act. Although the government was making progress in setting up credit administration it could not keep up with the demand of agriculture. Additional money was needed for the increases in crops, livestock, and new machinery that was being introduced. The World War caused an immense mobilization of farm forces to meet the needs of foreign nations. Our production on a war-time scale could not be easily dismantled and it continued its momentum until the year of 1920 when there was the highest all-time production. This year found the farmer in a poor condition to meet the crisis of 1920-1921. He had gone in debt to expand and prices were inflated--"The costs of production had gone up as he was forced to produce on marginal land." With his standard of living adjusted to an old price level he was helpless as the price of agricultural products began to decline. The United States Department of Agriculture estimated that the banks had outstanding to farmers, loans on personal and collateral

security to the amount of $3,869,891,415 in 1920.*

The Federal Reserve Banks furnished large sums of money but credit conditions became so bad that there was a revival of the War Finance Corporation which helped those states which were most in need. Banks receiving assistance from the Corporation used the money to liquidate their own indebtedness. This relieved the banks from their strained relations with borrowers and therefore the farmer was not pressed so hard.

From the period of 1920-1921 until 1929 the interest to help the farmer declined. All through this period of nine years the prices received by the farmer tended to lag behind the prices paid by him. This condition was grave and the federal government tried under the Federal Farm Board in 1929 to introduce more stable prices. The burden of debt of the farmer did lessen after 1928 but its cause was not from the establishment of the Farm Board. "The Bureau of Agricultural Economics reports that the outstanding total of farm mortgages rose from $3,300,000,000 in 1910 to $7,857,700,000 in 1920 and $9,468,526,000 in 1928. Thereafter, there was a considerable deflation of farm mortgage indebtedness." The total mortgage debt at present is about $8,000,000,000.*

The attempt of the Federal Farm Board was futile and it was replaced by the Farm Credit Administration in March of

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*This history is taken from "Ten years of Federal Intermediate Credits" by Frieda Baird and Claude L. Benner. A publication of The Institute of Economics of the Brookings Institution (1933) PP. 23-38.
*Major B. Foster and Raymond Rodgers--Editors, "Money and Banking" (1936) P. 587.

1933. Loans of $1,150,000,000 were outstanding at the close of the history of the Federal Farm Board and its losses are estimated from $350,000,000 to $400,000,000.

Political precedent had been established and it remained for the Farm Credit Administration to go into the banking business with the farmer; loans of $4,419,342,940 were made, $3,394,248,646 were outstanding June 30, 1937.* The Federal Land Banks and the Federal Farm Mortgage Corporation hold indirectly upwards of 40 per cent of the total amount of farm mortgages outstanding.**

As we consider the basis for such expenditure there is the question arising in what form of wealth will these loans be returned. Is it economically sound to lend in order that the farmer may owe an organization of the government rather than a private agency? Over a short period of time it may help an insurance company to remain solvent but the fact remains that only the status of the lender has changed. The government may be a more lenient lender, which is to its detriment, because it is not possible to deal in a business-like manner. These huge sums have been lent at a certain percentage of the valuation of the land and equipment, and where there has been mistakes in valuation as well as amortization of the mortgages the federal agencies will be responsible for this loss. In sustaining this loss it will finally

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*Business Week, "The Farm Market--Today and Tomorrow", September 4, 1937.
**Foster and Rodgers op. cit., P. 593.

resort to the taxpayer. It is not sound economics when money is lent in farm regions where there is no hope of a return.*

THE CONSTRUCTION PROGRAM

As in the farm problem the federal government has also considered by what approach our housing difficulties can be met. In the past five years mortgages have been bought to relieve home owners who would otherwise have had to lose their property, and housing programs have been aided by government credit. The European countries have dealt with the problem in a social way which may not be applicable to the United States. There is certainly not the highly specialized system of institutions for this purpose in the United States that there are in England. "In England it is estimated that 80 to 90 percent of the first-mortgage money for housing is supplied by building societies."** We do not have the same situations which exist in European countries and there must be built a construction program fitted to the problems of the United States.

There is the controversy that the government has gone too far in the financing of homes. Our experience in this field has been very expensive because of the loose standards set up during an emergency. No thought was given, or it was impossible, to the valuation of property or to the income of the mortgagor and what possibility there would be of a

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*See Appendix
**Ernest M. Fisher and Richard U. Ratcliff, "European Housing Policy and Practice", Bulletin of the Federal Housing Administration (1936) P. 3.

return on the money lent. It has been difficult for the government to collect the money owed since there has been such haphazard administration.

(1) Federal Home Loan Banks

This system of banks started in 1932 is a permanent institution. The purpose of this system is that of being a source of credit for its member institutions. It is under government charter and also under the supervision of the government. The Federal Home Loan Banks have no bearing in relation to being an expenditure, they are considered in the light of whether there is a place for them in our banking structure. A source of liquid funds wherein its member banks can borrow so that in time of need they can come to it. The mortgage-banking system of this country was lacking in this principle in a crisis and this institution has had high requirements.

In comparison with other governmental agencies aiding home owners it has been far more efficient, although it is a poor comparison with this institution having loans of $175,607,000 to that of the huge loans of the Home Owners' Loan Corporation, which are $2,497,224,000.* However, it must from the short experience with the Home Loan Banks be recognized that if the government must deal in housing it must do it on a sound basis.

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*Federal Reserve Bulletin, October, 1937.

(2) Home Owners' Loan Corporation

The government spent 199 million dollars in 1934 and 1935 for this agency. And it now has been taken over by the Reconstruction Finance Corporation which purchased its capital stock amounting to $38,300,000. This corporation is now in the process of liquidation. The government interest in this agency was $55,175,991 in 1936, the recovery of which seems rather doubtful.*

People could borrow from this corporation for maintenance, repairs, and taxes on their homes. The principle for consumption loans holds true here in that it is constantly a danger to the source of wealth for the individual to mortgage his future earnings for the present unless there is an amortization plan which is such that he can pay off his loan. The government has obligated itself to its security holders in order that it might lend. The question is, has it lent at fictitious values?

(3) Federal Housing Administration

Organized in 1934 for the purpose of improving conditions, this agency had a system of mutual insurance which would insure all eligible financial institutions against losses who would loan on the improvements of real property. Through 1936 its expenditures did not amount to over 30 million dollars.

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*George E. Anderson, Barron's, The National Financial Weekly, February, 1936.

There is a house shortage in the United States, and private enterprise has not been able to induce private credit to flow into the construction channel. The parallel may be drawn as to England who has financed her building boom from building societies. In 1919 the government in England had to take the initiative. "Governmental participation in housing is permanent, though its form is changeable. The complication of forces in this field has compelled European Governments to adopt comprehensive programs........ The direct lending operations of many of the Governments in the early post-war period and the various other forms of government participation in the real-estate and mortgage market occasioned by the post-war building crises have created a permanent interest in this field and resulted in a certain degree of dependence upon government assistance and control."*

The building program under the Public Works Administration was far too elaborate for the man with a low wage, and the program under the Resettlement Administration strove to accomplish too much in a short time. The present and future plans should be better because of this information. They should be more able to improve conditions and to help city planning.

FEDERAL EMERGENCY RELIEF ADMINISTRATION

This expenditure has been a very flexible item, one

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*Ernest M. Fisher and Richard U. Ratcliff, "European Housing Policy and Practice", Bulletin of the Federal Housing Administration (1936) P. 1.

depending upon industry to relieve the unemployment situation as business recovered. But it seems there was a lag in employment as business began to recover in 1935 and 1936; expenditures for relief were certainly not decreasing with such recovery, in 1934 there was spent $1,844 million, in 1935, $2,342 million, and in 1936, $2,250 million. The theory that revenues must be increased with no decrease in expenditures could result in no other way than add to an increasing national debt. As to greater returns in revenue, this was a program that had many weaknesses just as any corporation or individual plan which tries to make as much as it spends. In 1936 we had more people on relief than in 1933 yet business was 60 per cent better.* The government in shifting its emphasis to work relief was competing for labor, because it is true that we were not spending for direct relief to the extent that we were in 1933.

Beginning in 1933 there was $351 million for direct relief. In the spring of that year the Federal Emergency Relief Administration, the Civilian Conservation Corps, and the Civil Works Administration were created. The effect of the expenditures for these agencies was not known until the end of the fiscal year 1934.

After this administration machinery was put into motion it was inevitable that the government must revise the system of relief. From the experience of England there was some idea of the problems involved in giving direct relief. It

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*Roger Babson, May 9, 1936, editorial in Daily Oklahoman.

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*[illegible], May 9, 1936, editorial in Daily [illegible].

was up to the federal government to give a different guise to its administration. Direct relief reached its peak in 1935 when it amounted to $1,914 million. The Civil Works Administration was only a temporary part of the system and it was brought to a close in 1934. Its total expenditures were about $817 million. The conservation program, another form of work relief, is a larger amount than is realized. The expenditures for this agency has been $1,253 million for the period 1934 to 1936. The amount expended for agricultural drought relief is only 84 million dollars.

These expenditures are now absorbed to a greater degree by the Works Progress Administration. The administration of this agency is more productive than of the previous agencies, however, the main controversy concerns its efficiency in comparison with private industry.

PUBLIC WORKS ADMINISTRATION

By reducing unemployment and by giving purchasing power the Public Works Administration has served a necessary demand in the period of depression. The government does need to help during a critical period but it should be done in conjunction with private industry. In looking at all of our federal agencies there was no long range view taken, rather the idea of letting the expenditures develop as they would was the foundation. Some of these expenditures are resulting as regular or ordinary expenditures instead of being termin-

[illegible] to the Federal government to give a different relief to its administration. Direct relief reached its peak in 1934 when it amounted to $1,516 million. The Civil Works Administration was only a temporary part of the system and it was brought to a close in 1934. Its total expenditures were about 807 million. The conservation program, another form of work relief, is a larger amount than is realized. The expenditures for this agency has been [illegible] million for the period 1933 to 1936. The amount provided for agricultural drought relief is only 86 million dollars.

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PUBLIC WORKS ADMINISTRATION

By creating investment and by giving contractors power the Public Works Administration has served a necessary demand in the period of depression. The government does good to help during a critical period but it should be done in conjunction with private industry. In looking at all of our Federal agencies there was no long range view taken, rather the idea of letting the expenditures develop as they would in the transition. Some of these expenditures are resulting in useless or ordinary expenditures instead of being remun-

ated. The Brookings Institution states, "Sound finance remained for many months a goal to be attained if possible. It was with this objective in view that the Public Works Administration was at first tied in with the National Recovery Administration--the idea being that the amount of public expenditures might be adjusted in the light of the degree of recovery in private industry."*

This agency in September, 1937 was brought to an end. Allotments had been made to the amount of $2,759,172,739. At this time the President said that there would be a $500,000,000 regular expenditure for flood control, soil eroision prevention, river and harbor improvements, navigation aids, drought region reservoirs, reforestration, and related work.** These expenditures are to be administered by the departments and agencies doing such work. As was stated in the preceding paragraph that some of these emergency expenditures remain to become regular expenditures is no doubt true of the Public Works Administration. This shows the fallacy of spending; whether or not this work should be done or whether or not there should be a curtailment of expenditures are the questions to be asked before appropriation of this money. If it is to be a permanent appropriation it will be spent regardless of its need, and it may not always be wisely spent.

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*"The Recovery Problem in the United States". A publication of the Institute of Economics of the Brookings Institution (1936) P. 447.

**The Boston Globe, September 21, 1937.

TENNESSEE VALLEY AUTHORITY

The government entered upon this project in the spring of 1933 with many purposes in mind. Our national interest is now based upon the problem that has been caused in connection with the competition of this agency with that of the public utilities, but we must look to the major objectives back of the whole program in order to make a fair estimate of this agency. Flood control and conservation of soils and forests are an important consideration upon which our federal government is justified in developing this project.

Because of the differences between the states it was impossible for them to agree to a regional undertaking. It was not wholly political barriers that limited the states in this development, it was also because of the condition of the finances in the various states.

As far as there are economic possibilities which will save the soil and aid reforestation along with the creation of better conditions for agricultural and industrial production there is a reason for such an expenditure. However, there is much criticism of the advantages that will result from the Tennessee Valley Authority.

From the standpoint of income from its transmission of electricity, the government will probably show a deficit for a long time. This organization which is supposed to be a yardstick concerns a great many people, both as producers and as consumers. The limited market and the low rate at which the

government must sell give no opportunity for a profit.

We are beginning to see that even under favorable conditions hydraulic developements are not as profitable as we have thought. Frank Williams writes of the increasing cost of water-power--"In former years when small water-power plants were developed the costs were as low as $70 and $100 per kilowatt. By 1900 the average cost had risen to $150 per kilowatt and by 1920 it had reached $200 to $250 per kilowatt; recent estimates on undeveloped sites have varied from $300 to $600 per kilowatt. This cost includes real estate, water right, and a large number of other costs which have to be met. This means that the fixed charges are high although the operating costs may be small.

"Futhermore, whereas the hydro-plant seems to have very nearly reached its highest efficiency, the steam plant has not approached its ultimate efficiency. This with relatively higher costs for hydroelectric development and decreasing costs for fuel generation of power the former will be used largely only in especially favored areas or in border-line areas after careful consideration. Water power, then, is not always a free gift of God nor does it represent so much 'velvet'".*

The expenditure by the government for the Tennessee Valley Authority has been approximately 96 million dollars. This outlay has not been very large in comparison with

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*Frank Williams, "Our Natural Resources and their Conservation" edited by A.E. Parkins and J.R. Whitaker (1936) P. 329.

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"Furthermore, whereas the hydro-plant seems to have very nearly reached its highest efficiency, the steam plant has not approached its ultimate efficiency. With high relatively higher costs for hydroelectric development and decreasing costs for fuel generation of power the former will be used largely only in especially favored spots or in conjunction with other useful developments. Water power, then, is not always a free gift of God nor does it correspond to such '[illegible]'".[1]

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[1]Frank Williams, "Our Natural Resources and Their Conservation" edited by A.E. Parkins and J.R. Whitaker (1936) P. 320.

relief, agricultural aid, and public works expenditures but it is the groundwork for that flood control program which is to follow. The proposal before Congress now entertains the idea of seven regional sections so that conservation may be facilitated in the United States. The initial cost of such a vast enterprise is of concern from a tax-paying standpoint.

VETERANS'BONUS

In 1920 when there was a proposal for a service men's bonus from 1 to 2 billion dollars the Secretary of the Treasury wrote the following opinion: "If we have to find new sources of revenue or if we increase present taxes, we shall further burden industry, probably curtail production, and in any event increase the cost of living."* This statement was made sixteen years later but it was not considered.

This act which was legislated in 1924 was a fund set aside for the benefit of service men and each year Congress was to make appropriations to it. The Chamber of Commerce estimated the value in 1936 at $2,188 million, which would require about $1,702 million to pay a bonus.** The actual expenditure was $1,673 million.

The President vetoed such a payment but it finally passed. This expenditure did not have any relation to re-

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*Annual Report of the Secretary of the Treasury--1920
**Business Week, January 11, 1936.

covery nor was it a matured obligation. We have not come to the recognition of what it means to pay out huge sums of money at one time, rather than having a system of amortization for paying off government obligations. There can be no semblance of a rational budgeting policy where there is no reliability that the plans introduced will be followed. Naturally, business is disturbed by the injection of such funds when it is from an artificial source. It is not normal and in a period of rising prices it will accelerate its movement. Both from the standpoint of government financial policy and from the disturbance of business our government bonus systems are unsound.

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its movement. Aside from the standpoint of a definite finan-
cial policy and from the standpoint of [illegible] the govern-
ment [illegible] the [illegible].

Chapter 2

Federal Debt

HISTORY OF DEBT POLICY

The greatest burden of debt has been caused by war, as is seen in the history of the United States. In the years through 1914 to 1916 the budget was practically in balance, the public debt stood at $1,225 million in 1916. Then within three years it grew to $25,482 million.

Such a vast amount of credit can only be obtained very readily in time of a crisis. The credit of the government in time of war is very good and people will readily buy its obligations with no concern for the future. There is no thought of taxation, the usual reason being that it cannot be administered very efficiently in a short time. The other reason is that taxation in time of war would assume proportions of confiscation. People will buy Liberty Bonds with no chance for a return but when they give up their money in the form of taxation it is with not the same loyalty. Sound economics is unpleasant in personal relationships, credit makes the machinery run much smoother, and this is likewise true in the function of government.

Large expenditures not only arise during the war but many expenditures continue after a war. The World War has resulted in the giving of pensions which are a large part of our expenditures. From 1932 to 1936 our expenditures

for pensions have amounted to $3,690 million, this does not include the veterans' compensation paid in 1936.

The federal government prior to 1933 has not raised money by borrowing to any great extent for any other purpose than for war. Public works have been left to the states and municipalities to develop. In the experience of state financial history there was a lesson which was probably impressed upon our national government.

The experience of the federal government has been very favorable, even in the face of the huge debt after the war. By 1920 it began paying off its debt and lowered the outstanding debt to $16,185 million in 1930. This period which illustrated the fact that we could pay off such a large amount was to our detriment. Because of the favorable experience of the past we are now making our financial policies upon such a precedent. That period of industrial expansion was unusual that gave the individual and the corporation a large ability for paying taxes.

FOREIGN OBLIGATIONS AS ASSETS

Up to 1930 there was $11,641,508,460.00 owed to the United States by foreign governments. They have given their obligations to this country which if they could be considered as assets would reduce our national debt by that much. However, there have been many propositions to cancel them and they may be considered such in fact even if not in that of a written agreement.

In 1931 there was a moratorium on war debts and since France defaulted in 1933 there has been no reduction. Such payments by Finland and arrangements whereby England could pay off an amount in silver are insignificant. The thirteen debtor nations owed $1,680,170,447 on December 15, 1937. This amount represented regular installments due on that date and payments in arrears.*

DEFICITS AND CREDIT

The recovery of the world from the war was very irregular. There were no stable conditions in those countries which felt the greatest effect of this disaster, England may be an exception to this group. Nations were prone to be lax with government credit. The governments issued currency which could never be redeemed at its actual worth.

Whether or not it is a loan from the people by inconvertible currency or whether or not it is a loan by the people buying worthless bonds it has the same result--the government has not operated upon sound principles. Continued deficits running for a number of years cannot help but lessen the government credit. "Borrowing to meet habitual deficits is merely the use of public credit to pay current expenses."**

All credit of government rests upon the power of taxation. Individuals look at taxation as an expense just as they look at their other necessary expenses. The prospects

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*The Boston Globe, December 9, 1937.
**Harley L. Lutz, "Public Finance" (1929) P. 592.

of the future are determined upon the difference between income and expense and if this difference due to taxes narrows too much they must turn to avoidance or operate at a loss. Considering that a government will operate on the credit system, it must realize what its functions are, and the judgment of those functions will be based on the capacity or willingness of its people to pay taxes.

In this period that is being studied, especially 1932-1936, the paradox of trying to live at a standard of the years of 1928 and 1929 is very puzzling. We were willing to economize but we did not think in terms of depression. The standards of the former years were looked upon as a goal. To think of the future in relation to the past is sometimes a hazy picture because there are not the conditions of the past.

Industry has not been able to bring about the normal conditions desired and, therefore, the government has used its credit. The deficits of the past six years are partly emergency and some of them are for current expenses. An examination of the cause of these deficits shows that there is a degree of permanence in their character. "The tendency to shift what originally were relief or emergency expenditures to more or less 'regular' expenditures, or to new names suggesting 'recovery' or 'development' rather than 'relief'. This indicates that such disbursements may become

permanent charges on the national budget."*

Deficits**
(In Millions)

1931	$ 903
1932	3,153
1933	3,068
1934	3,989
1935	3,575
1936	4,764

FINANCING OF GOVERNMENT BY BANK CREDIT

The insured banks held $3,800,000,000 worth of government securities in 1929 and on June 30, 1937 they held $14,000,000,000.*** Over one-third of the national debt is held by banks. This has caused a great change in our banking field along with the significant factor that it has laid the ground work for inflation, not in printing of currency fashion but which will practically amount to the same thing.

Banking has become an investment business instead of a lending business. Leonard P. Ayres shows this difference in that income from loans was 65 per cent in 1929 of total income earned by banks, in 1936 it was reduced to 30 per cent; income from investments in 1929 was 21 per cent in 1921 and 56 per cent in 1936.****

The government agencies have gone into the extension of credit where it was otherwise impossible to obtain it, and insurance has been also added as an assuring factor

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*National City Bank Monthly Bulletin, February, 1937.
**Ibid.,
***Ibid., November, 1937.
****The Cleveland Trust Company Business Bulletin, August, 1937.

for the enlargement and strengthening of a system of credit. It seems to be a circle in which we are traveling, the government borrows from the banks to lend. An answer to this would be that there were no banking facilities where the government is now lending. This is not wholly true because banks will not lend unless there are prospects for a return, whereas, the government has lent on a large scale in fields where the bank was hesitant to lend.

Now in consideration of the facts which our borrowing from the banks imply: If the government had received from individuals an actual sum in dollars for its obligations issued there would not be an increase in the supply of credit, but in the case of the government issuing bonds to banks and receiving credit there would be an increase. The banks count this as a deposit just as if material funds were brought there. The issuance of such credit eventually brings price advances and this in turn causes speculation in inventories, and it causes labor and agriculture to agitate for an adjustment with prices. As prices continue wages tend to seek new levels. At this stage the government has to set out to cure by deflation the exorbitant prices it caused. The cry of inflation in the United States was not unfamiliar in 1936, for which cry the government has had to give some consideration for an adjustment in prices.

INTEREST RATES AND INVESTMENT

The flotation of securities by private enterprise has

been very small during this period. Corporations were able to expand at this time because of their surplus, and there was no reason for some corporations expanding since they could not see any gain. That is, savings other than their own were not used at this time to invest in industry.

Because of the scarcity in the supply of securities and lack of confidence in corporate obligations savings sought a place of earning and it was placed in federal obligations. The issues offered by the government have been readily absorbed, which has also been favorable to the obtaining of reduced interest rates. "One striking effect of the depression has been the creation of a discrepancy between rates paid by the government and those paid by private industry and by individuals. This has been true not only of the United States but of other countries, where-ever the credit of the government was strong. In the United States, in spite of a greatly expanded volume of short-term borrowing, the rates paid by the government on short-term certificates have been almost at zero level for several years."*

There is a difference between the interest rates which private corporations pay and that which government pays because of the greater amount of security and also because of tax exemption of the interest. Banking institutions

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*"The Recovery Problem in the United States", A publication of the Institute of Economics of the Brookings Institution (1936) P. 384.

have also been restricted in their investment policies which adds to the demand of government obligations.

Interest Rates*
(Percentages)

	Government Bonds	Railroad	Public Utilities	Industrial
1928	3.877	4.34	4.68	4.88
1929	3.946	4.61	4.86	5.06
1930	3.807	4.39	4.65	4.95
1931	3.566	4.61	4.60	5.51
1932	3.505	5.99	5.36	7.46
1933	3.350	5.64	5.18	6.93
1934	3.181	4.65	4.61	5.54
1935	2.715	4.93	4.31	4.61
1936	2.562			

The difference between the interest rates on government bonds and that of railroads, which had the lowest interest rates of three groups shown, was only 0.47 per cent in 1928. In 1935 the difference between interest rates on government bonds and that of public utilities, which were the lowest of the three groups, was 1.595 per cent.

REFUNDING AND THE EXPENDITURE OF CARRYING A LARGE DEBT

As was shown above, the government has been able to reduce its interest rates during the depression. It has refunded many of its issues into newer issues bearing a lower interest rate. This has had a decided effect upon the amount of interest paid on the outstanding debt.

The table on page 29 shows that the gross debt has

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*Ibid., PP. 362-363.

doubled in the last six years with the interest on the public debt showing an increase of 138 million dollars or a 22 per cent increase. Because of a decrease in interest rates the expenditure was reduced about 72 million dollars from 1935 to 1936.

Gross Debt and Interest Payments*
(In Millions)

	Gross Debt	Interest on Public Debt
1931	$16,801	$611
1932	19,487	599
1933	22,539	689
1934	27,053	757
1935	28,701	821
1936	33,719	749

What are the prospects for the future of larger interst payments? Senator Byrd of Virginia speaks of the future with an alarming note--"When the obligations come due--and fifteen billions are due in the next five years--we face a likely increase in existing rates. The obligations given by the government to the Social Security Trust Funds bear by law 3 per cent interest--an increase of one-half per cent over the average rate now paid. An increase in interest rates will remain for a long time as a potential new burden on the Treasury. An increase of 1 per cent means $400,000,000 annually more to be paid by taxation."**

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*From the annual reports of the Secretary of the Treasury
**Harry Flood Byrd, an address before the Academy of Political Science in New York, November 10, 1937. Printed in the United States News.

Interest Bearing Federal Debt*
(In Millions)

Year Ending June 30	Long Term Bonds	Intermediate Term Notes	Short-Term Certificates	Short-Term Bills	Total
1930	$12,111	$ 2,390	$1,264	$ 156	$15,922
1931	13,531	621	1,924	445	16,520
1932	14,250	1,465	2,831	616	19,161
1933	14,223	4,780	2,200	954	22,158
1934	16,510	6,932	1,635	1,404	26,480
1935	14,936	10,501	156	2,053	27,645
1936	18,628	11,861	146	2,354	32,989

There is a large portion of the federal debt in short-term obligations which will have to be replaced as Senator Byrd recognizes. $13,735 million worth of obligations outstanding has an interest rate of 2 per cent or less, the $1,735 million additional which makes $15,467 million is in long term bonds. The government would be fortunate if it could re-issue all of these obligations to the Social Security Trust Funds at 3 per cent. As soon as its obligations go into the competitive market, business resembling somewhat normal, the government will have to raise the rate.

Since March 1933 the agencies of the federal government have lent more than ten billion dollars. All of these loans are for a period of twelve years or longer and about half of them for forty years or more.** We have done the same thing England did before 1931; we have borrowed on short-term obligations and extended loans on long term obligations.

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*"The Recovery Problem in the United States", a publication of the Institute of Economics of the Brookings Institution (1936) P. 665.
**Major B. Foster and Raymond Rodgers--Editors, "Money and Banking" (1936) P. 129.

DECREASING EXPENDITURES OR INCREASING REVENUE

It seems obvious that there is but one way to turn. As one looks over the deficits that we have accumulated and sees the possibilities for new taxes it is evident that we cannot make up the difference in new levies. Not being able to balance the accounts of the government, is it advisable to continue spending? There are many estimates as to how far the government can go without endangering her credit. And there are many who believe in the policy that the government should spend as long as it is necessary to provide for the social needs of the people. However, it is difficult to determine just what social needs are, and even if the government could maintain its credit up to 60 billions of dollars it would not be common sense to try and test it to its final limits.

"Under existing economic conditions, unbalanced budgets are among the most baffling problem that governmental authorities have to face. Ordinarily these authorities have attempted to balance their budgets by increasing tax rates, by decreasing expenditures, or by a combination of the two methods. When they have failed by such methods, which has often happened, they have resorted to borrowing.

"The policy of contraction--enforced economies in expenditures--has apparently produced balanced budgets in a few instances. One of the most successful attempts to apply this policy is embodied in the so-called Premiers'

Plan of Austrailia, which was carefully worked out on the basis of 'equality of sacrifice' and adopted in 1931. It has been employed in the balancing of the commonwealth and state budgets, and thus far has shown remarkable results.

"Opposed to the policy of contraction in balancing the budget is the expansionist policy. The latter proposes the use of public credit to increase expenditures for capital improvements and to aid in the planned extension of private production. It is claimed that the effect of applying this policy, once its full force is felt in a country, is to increase revenues and to decrease unemployment relief. Thus the budget is eventually balanced; futhermore, the causes of budgetary disequilibrium are largely removed. The authorities of several governments have seemingly followed this policy, at least in part, and have provided funds for a program of capital improvements and national development. The United States government embarked upon such a program under the New Deal. It did not, however, go wholeheartedly in this direction, but attempted to carry out, at least for a time, a policy of contraction with respect to the ordinary services of the administration. While it is yet too early to determine the economic effects on the country of this approach to the problem of budgetary balancing, such effects, judged from present indications, are likely to be much less satisfactory than was originally anticipated."*

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*A.E. Buck, an article in "Taxation and Public Policy"--
edited by Paul Studenski (1936) P. 29.

TAXES FLUCTUATE WITH BUSINESS--THE BURDEN ON BUSINESS IN INDUSTRIALIZED SOCIETY

The majority of our federal taxes are assessed upon business. If we eliminate the individual income tax and the estate and gift tax we could consider the revenue received from the corporations and the various excise taxes as business taxes. However, the individual income from rent, interest, and dividends, likewise, the value of all tangible and intangible property inherited or received as a gift is determined by the condition of business. Also the better business conditions are, the greater the return in the individual income tax report.

Taking our revenues as a whole it may be stated that the basis of federal taxation is upon business. "The Federal Government in recent years has obtained by far the greater part of its revenues from business. In 1930, two-thirds of the total Federal taxes were secured from business, and by 1935, four-fifths of the total Federal taxes were secured from business. The great preponderance of state taxes is also procured from business. In 1934, for example, the states derived over one-half of their total taxes from business, excluding property taxes paid by business. The local governments, to be sure, obtain roughly nine-tenths of their tax revenues from imposts on property, but a large part of the property tax receipts

come from business."*

In the depression of 1930-1934 it is estimated by Leonard P. Ayres that business was 41 per cent below normal. This is the greatest effect that any depression has had on business. At the time business is having its worst difficulties it has to bear the greatest taxes. Business has ability to pay taxes and it should pay but it has no miraculous powers to pay unlimited taxes.

FEDERAL GOVERNMENT AS CONTRIBUTOR TO NATIONAL INCOME

The government has added a large amount of money to our purchasing power. Every expenditure above the regular expenditures has been used to stimulate a flow of funds. There have been comparisons between federal contributions to purchasing power and the increase in our national income. The amounts paid out have had a tremendous influence but it is difficult to determine how much influence they have had. To state that the increase in the national income was entirely the result of government expenditures would indicate a false recovery. "Under a program of pump-priming the national income rose from 40 billion to 70 billion dollars--an increase of 30 billion--while the government was borrowing and spending 11.3 billion. The turnover of this 11.3 billion is credited by the planners with causing most of the 30 billion increase."**

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*Alfred G. Buehler, an article in the publication by the Tax Policy League, "How Shall Business Be Taxed" (1937) P. 46.
**The United States News, November 1, 1937.

This policy is not sound and it can easily lead to prices getting out of proportion to their real worth.* "Inflation is such a broad term that we often do not recognize it as an economic disease because we look only for such conspicuous symptoms as the actual circulation of printing-press money.

"But we have just completed the first stage of New Deal inflation--the studied effort of an administration by the use of governmental power to boost prices and values to artificial heights.

"The next stage will witness a struggle between those who want a resumption of the hypodermic--more government spending--and those who want to try to let America recuperate by natural strength.

"The history of every inflation the world has ever known reveals that when the critical moment of choice comes, the demand is pressed that government do over again the things which led to the first period of imaginary prosperity.

"'Deficit financing', as the experts call it, is nothing more nor less than inflation. It is a means of stimulating the business activity of a nation by supplying purchasing power out of funds borrowed from the labor and productivity of future generations."**

In order that a government can secure funds there must

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*See appendix
**Ibid., October 25, 1937. The above quotation is taken from an editorial by David Lawrence.

be an availability or surplus of funds that are seeking investment. To create this wealth it must come from productivity. The issuance of a note and receiving money for it is not the creation of wealth. Therefore, when the government receives money from a loan the basis for the loan is in the resources of the borrower to repay that loan. If the government meets the needs of its people but in return the people or institutions aided cannot repay the loan, either directly or indirectly in the form of work so that they increase a source of funds which can later be taxed, there is a loss to the government and a lessening of the national income. The qualification for expenditure is that it must be productive.

THE FEDERAL EXPENDITURES OF THE FUTURE

The maxim that expenditures of governments continue in but one direction, and that is always towards larger growth, makes the question of the future a very serious one. It is definite that we shall carry a heavier burden of taxation as a result of the borrowing of the past.

When we consider paying off the debt of the past in time of prosperity, it is taken for granted a surplus will be available from revenues in excess of expenditures. From the experience before 1931 there was a gradual reduction of debt, partly due to foreign repayments but mainly because we were able to bear a larger amount of taxation. The budgets were thought of in terms of not more than 4 billions

of dollars--now when one thinks of surplus in federal finance he must think in the terms of 6 billions of dollars. Conservatively speaking, for the next three or four years we will be well off if our expenditures can be met with a budget of 6 billions of dollars.

The Twentieth Century Fund study of expenditures suggests the probability for the future. For 1938 federal expenditures would amount to about $7,000,000,000. Upon the assumption that business would improve the 1940 total would be $5,300,000,000, and this does not include debt reduction. "These figures allow for certain non-tax revenues other than loans. They do not include the contributions to the old-age benefit reserve fund, and they assume only the statutory amount of Federal debt retirement, which is between $400,000,000 and $600,000,000 a year." Then upon the assumption that business conditions did not improve above the 1936 level, the federal expenditure would be $6,100,000,000. Balanced budgets could be achieved by 1940 if our revenue is increased by $3,400,000,000 over the 1937 revenues, or about $8,000,000,000. No estimate is made if business conditions were worse than in 1936.*

REGULAR EXPENDITURES VERSUS EXTRA EXPENDITURES

Since 1934 we have classified our expenditures as 'General' and 'Recovery and Relief'.. There has been a tendency

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*Twentieth Century Fund, Inc., "Facing the Tax Problem" (1937) P. 443.

for some of the items of an emergency nature to be classified as regular expenditures. The table below shows the regular and emergency classification of expenditures.

Federal Expenditures--1931-1936*
(In Millions of Dollars)

	1931	1932	1933	1934	1935	1936
Regular	3,168	3,249	2,715	1,705	1,732	3,277
Veterans' Payment						1,673
Debt Expenditure	1,052	1,012	1,151	1,116	1,394	1,152
Emergency		893	1,277	4,284	4,250	2,777
Total	4,220	5,154	5,143	7,105	7,376	8,879

*From the annual reports of the Secretary of the Treasury.

Chapter 3

Federal Taxation

From the reduction of taxes in 1928 we have with each new act since 1932 raised our taxes to obtain greater revenue. In the two previous chapters it was shown upon what basis our taxation rests. It has shaped our tax policy, whether or not it is a justified basis.

The question is not so much what shall our taxes be, this is already fixed by our past expenditures, it is how the imposition of taxes can be distributed so that they will not be injurious to some and beneficial to others. We have introduced the method of reform in public finance which precludes the theory of a just tax, where each should carry an equitable part.

Some of our industries because of a greater control by the government in theory rely on the government to a greater extent than they formerly have. Since the government has had to assume this control there is a greater benefit rendered and some one must pay for this benefit. The ones most likely to pay are the individuals or corporations upon whom the incidence should fall to cause the reform the government wishes.

When reform is brought on the end in view is often lost. Both ends or objectives, such as, proper conduct by individuals along with adequate revenue are desirable but can they be obtained by the same means? Reform measures

call for readjustment and usually financial loss; to maintain or to increase revenue calls for equilibrium so that the object of taxation may have ability to pay.

SUMMARY OF THE REVENUE ACTS*

The 1928 Revenue Act decreased the rate of tax upon corporations from $13\frac{1}{2}$ per cent to 12 per cent. As to the individual income tax the earned income credit was the only change, the credit allowed was increased from $20,000 to $30,000. The tax of 3 per cent on manufacturers' sales of passenger automobiles was repealed. There were taxes on admissions which were given a higher rate of exemption. Some of the other excise taxes were repealed or modified.

The 1932 Revenue Act increased the rate of tax upon corporations from 12 to 13 3/4 per cent. There was an additional tax of 3/4 of 1 per cent upon corporate income filed on a consolidated return. The individual income tax was increased both as to normal and surtax rates; the normal tax was increased from $1\frac{1}{2}$, 3, and 5 per cent to 4 and 8 per cent, for surtax rates those in excess of $6,000 and not in excess of $10,000 were taxed 1 per cent then the surtax was graduated up to 55 per cent on net income in excess of $1,000,000. There was an elimination of tax credit for earned income and personal exemption was reduced from $3,500 and $1,500 to $2,500 and $1,000. The deduction of losses was

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*This summary with the exception of one quotation is taken from the annual reports of the Secretary of the Treasury.

restricted to the amount of the gains if the losses were on stocks or bonds held for two years or less. These losses may be carried over for a year but there are limitations as to the excess of such losses over gains.

Exemptions on computing estate taxes are reduced from $100,000 to $50,000. Tax rates were graduated from 1 per cent minimum to 45 per cent on estates over $50,000,000. There was no additional credit allowed for payment of state inheritance taxes. The gift taxes were graduated up to 33 1/3 per cent on net gifts in excess of $10,000,000.

There were increases in many excise taxes, increases in miscellaneous taxes, and new postal rates.

For 1933--"The most notable changes were in connection with the tax imposed and authorized to be withheld upon corporate dividends, the tax upon the declared value of corporate capital stock, the excess-profits tax of 5 per centum imposed upon the net incomes in excess of 12½ per centum of the declared value of the capital stock in the business, and the processing taxes authorized by the Agricultural Adjustment Act. The most important new source of revenue was created by the act of March 22, 1933, which legalized the manufacture and sale of beer and wine having an alcoholic content of not more than 3.2 per centum by weight."*

The 1934 Revenue Act provided that railroads were the

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*Annual Report of the Commissioner of Internal Revenue--1933.

only corporations privileged to file consolidated returns, and for this privilege there was an increase in the rate from 14 3/4 to 15 3/4 per cent. For corporations accumulating a surplus to avoid payment of surtax by shareholders, there was a change in the special surtax from 50 per cent of adjusted net income to 25 per cent of the amount not in excess of $100,000, plus 35 per cent of the amount in excess of $100,000. Losses were limited to $2,000 in excess of gains. Upon personal holding companies a special surtax of 30 per cent of the undistributed adjusted net income not in excess of $100,000, plus 40 per cent of the amount in excess of $100,000.

The normal tax on individual incomes was changed from 4 and 8 per cent to 4 per cent. For the purpose of the normal tax a credit was allowed of 10 per cent against net income. For the surtax a credit for personal exemption and exemption for dependents is allowed; surtax rates are graduated from 4 per cent in excess of $4,000 to 59 per cent on surtax net income in excess of $1,000,000. Gains and losses are computed upon the time held, the percentage allowed decreases the longer the asset has been held.

Estate tax rates were increased so that the maximum tax on net estates in excess of $10,000,000 is 60 per cent instead of 45 per cent; gift tax rates were increased so that the maximum tax on net gifts in excess of $10,000,000 is

45 per cent instead of 33 1/3 per cent.

"Revenue legislation during the fiscal year 1936 included two major revisions of the Federal tax system: (1) the Revenue Act of 1935, approved August 30, 1935, and (2) the Revenue Act of 1936, approved June 22, 1936.

"The Revenue Act of 1935 increased all the individual income surtax rates applicable to surtax net incomes over $50,000, raising the maximum surtax rate from 59 per cent applicable to surtax net incomes of over $1,000,000 to 75 per cent applicable to surtax net incomes of over $5,000,000. All the estate and gift tax rates were increased by this act; the maximum estate tax rate was revised from 60 per cent applicable to net estates of over $50,000,000, and the maximum gift tax rate was changed from 45 per cent applicable to net gifts of $10,000,000 to 52½ per cent applicable to net gifts of over $50,000,000. The specific exemptions for both the estate and the gift taxes were reduced from $50,000 to $40,000. The Revenue Act of 1935 also introduced two new features into the corporation income tax: (1) It substituted a graduated tax for the single rate of tax which had been imposed under all earlier acts; the rate scale was graduated from 12½ per cent upon the first $2,000 of net income to 15 per cent upon net incomes of over $40,000, as against the flat rate of 13 3/4 per cent imposed under the Revenue Act of 1934; (2) It subjected 10 per cent of the dividends received

by corporations to the corporation income tax whereas under earlier acts all dividends received by corporations were exempt from tax.

"The Revenue Act of 1936 did not change the surtax rates of the individual income tax or the estate and gift tax rates which were imposed by the Revenue Act of 1935; it did, however, change the corporation income tax by superimposing upon a graduated normal corporation income tax rate scale (somewhat lower than that imposed by the 1935 act) a scale of surtaxes on undistributed profits graduated from 7 per cent to 27 per cent.

"Under the Revenue Acts of 1934 and 1935 railroad corporations were permitted to file consolidated returns and a tax rate of 15 3/4 per cent was applicable. This privilege is continued under the Revenue Act of 1936 but this act does not distinguish between the rates applicable to corporations permitted to file consolidated returns and other corporations. The 1936 act increased the tax upon intercorporate dividends by subjecting 15 per cent of the dividends received by corporations to the corporation income taxes, instead of only 10 per cent as in the 1935 act. The chief change in the individual income tax made by the Revenue Act of 1936 was to subject dividends received to the normal income tax for the first time in the history of Federal income tax legislation.

"Important changes were also effected in the taxation

of nonresident aliens and foreign corporations. Under the Revenue Act of 1934, nonresident alien individuals were required to file returns on income from sources within the United States and were subject to both normal tax and surtax. On annual or periodical gains, except dividends, a tax of 4 per cent was withheld at source to be credited against the total amount of tax as determined on the return. Similarly, a tax of 13 3/4 per cent was withheld on the same items of income of foreign corporations.

"The 1936 act provides for a 10 per cent withholding tax applicable to nonresident aliens not engaged in trade or business in this country on gross income from interest (except interest on deposits with persons carrying on the banking business), dividends, rents, royalties, and other annual or periodical sources of income within the United States. Such nonresident aliens are not subject to the tax on capital gains. Similar items of income are taxable to nonresident foreign corporations at a 15 per cent rate, except dividends, which are subject to a tax of 10 per cent. The 10 per cent rate on dividends may be reduced to not less than 5 per cent if the recipient is from a contiguous country, and provision for such reduction has been effected by treaty with such country.

"Resident foreign corporations are subject to a flat tax of 22 per cent on income from sources within the United States. They are not subject to the surtax on un-

distributed profits.

"Nonresident alien individuals doing business in this country are subject to normal tax and surtax on income from sources within the United States.

"A number of other changes were effected by the Revenue Acts of 1935 and 1936.

(1) Certain corporations are not subjected to the graduated normal tax and to the graduated surtax rates on undistributed profits; banks, insurance companies, foreign corporations, and certain others are required to pay various flat rates in lieu of the normal tax and surtaxes imposed on other corporations.

(2) The 1935 act made no change in the tax on corporations improperly accumulating a surplus; the 1936 act decreased the rates applicable to corporations subjected to the surtax on undistributed profits, but made no change in the rates applicable to corporations not subjected to such tax. The 1935 act increased the surtaxes on the undistributed adjusted net income of personal holding companies; the 1936 act decreased these rates.

(3) The capital stock tax rate was increased by the 1935 act and reduced by the 1936 act so that it stands at the same level as in the Revenue Act of 1934, namely, $1 per $1,000 of the adjusted declared value of the capital stock. Corporations were permitted under the 1935 act to redeclare the value of their capital stock. The excess-profits tax was increased and graduated by the 1935 act as against a flat rate in the 1934 act, and the excess in the 1935 act was to be measured from a lower level than in the 1936 act.

(4) The 1936 act imposed a tax on the unjust enrichment arising from: (a) Federal excise taxes shifted to vendees but not paid; (b) Federal excise taxes shifted by vendee for which he was reimbursed by the vendor; or (c) refunds or credits of such taxes shifted to others.

(5) The 1935 act reduced the tax on producers of crude petroleum. The 1936 act elimInted the jewelry tax; reduced the rate of tax on furs, but eliminated the exemption from tax of articles made of fur which sold for less than $75; and imposed a tax on the import of certain additional types of oils and of certain seeds from which oils are derived.

"Important special taxes were imposed by legislation enacted during the fiscal year 1936. The Social Security Act approved August 14, 1935, imposed three taxes; (1) An income tax on employees, with certain exceptions based upon wages received not in excess of $3,000 per annum; (2) An excise tax on employers, with certain exemptions, based upon wages paid not in excess of $3,000 per annum; and (3) An excise tax on all employers of eight or more, based upon the total wages paid."

INDIVIDUAL INCOME TAX

The income tax on individuals has been assessed most heavily upon the larger incomes. Either in the time of war or in the time of depression the income tax has been used. In the Civil War, the period of 1894, the World War, and in our latest depression there has been a new emphasis upon the income tax.

It is a tax that is very important in our taxation system. In the last three years there have been collected from the individual income tax $419 million in 1934, $527 million in 1935, and $674 million in 1936.

(1) Progressive Taxation--Is the Upper Limit Reached?

The 1935 Revenue Act imposed rates of a normal tax of 4 per cent and a surtax with graduated rates from 4 per cent on surtax net income in excess of $4,000 to 75 per cent on surtax net income in excess of $5,000,000. With this rate there is a certain point above which it takes almost

all the income received. The taxpayer can well consider whether or not it is worth the extra energy and the risk of his capital to produce income which is not really his.

Progression is the accepted principle of taxation, no matter how sound or unsound. Since there is no alternative the way of avoidance and evasion has taken the place of agitation for a new revision of tax laws. The taxpayer has taken advantage of all possible deductions from his income and he has used the corporation as well as the personal holding company to avoid high surtaxes. The weakness of high surtax rates are seen in the formulation of the 1935 act. People immediately formed personal holding companies in the Bahamas, Newfoundland, and Panama. In the last four years there have been 202 personal holding companies formed in Newfoundland and the last two years there have been 46 formed in Panama.* There are other devices by which the taxpayer may avoid taxes, and it has been the opinion of the Supreme Court that a taxpayer is justified in reducing his tax to a minimum so long as the law permits.**

The government finds new laws to meet these situations but it causes an increasing amount of administration and expenditure. The increase in revenue may not warrant the enactment of new tax laws because of added expenditures to enforce such laws, and also the ill effects or unpopularity

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*The Boston Globe, June 18, 1937.
**"Alexander Federal Tax Course", Alexander Publishing Company, Inc. (1937) P. 394.

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*The Boston Globe, June 16, 1937.
**"Alexander Hamilton Tax Course", Alexander Hamilton Institute, Inc. (1937) P. 226.

caused by taxes on the higher incomes. These large concentrations of wealth have taken many years to build and the tradition of the function of our government is against a rapid elimination of what one has accumulated. Reform in redistribution of wealth cannot come as fast as legislation is introduced. Some of our taxes are excessive and they have had a bad effect as far as the educative function of law is concerned.

(2) Regressive Taxation--The Prospect of the Future

When there is a period of prosperity people are not concerned with taxation because they are better able to share the burden. But as business recedes, and it is definite that they are feeling the burden of taxes, there is an anxiety as to what the government policy will be in both expenditure and taxation. We have not reached this stage yet, where the taxes on lower incomes make the people as a whole more conscious of how much government costs.

Now as it seems inevitable that the budget cannot continue without being balanced, the sources of taxation that have not been reached must be studied. It is dangerous for politicians to even think of a direct tax on the general public but it is just as dangerous to government credit to think otherwise.

Progressive taxation will still yield more revenue than it has, but it will not be adequate, and as for taxes on corporations they are carrying the biggest share of taxation.

The excise taxes may be increased and new ones brought into existence but they have certain limits to which they can be expanded before the people are aware of higher prices and they realize this is a tax as much as a direct income tax.

It is difficult to see how there could be an increase in taxation on larger incomes and incomes of corporations without an increase to a small degree in the taxation of small incomes. The limits to taxation of the lower incomes are soon reached, however, they should now pay in proportion as taxes are now increased upon other sources. Politicians may delay for years but they must ultimately face it. Periods of business activity may help to enlarge revenues if they are equal to our 1929 period, even then, our administration of public funds will have to be far better than that of 1929 to meet expenditures, not considering any liquidation of the huge debt. With these conditions it is likely that there will be a taxing of small incomes.

CORPORATION INCOME TAX

(1) Normal Tax on Corporations

The 1936 tax rates on net income are 8 per cent on net income not over \$2,000, 11 per cent on net income over \$2,000 and less than \$15,000, 13 per cent on net income over \$15,000 and less than \$40,000, and 15 per cent on net income in excess of \$40,000. (There are corporations which are not included in the above graduated scale but they have

been listed in the summary of the acts).

The theory of the taxation upon corporations has been not of ability to pay because the corporation is set up for the stockholders and it is not actually a separate entity within itself although it may be legally such. The theory that it received benefits as a corporation from the government has been its basis. To tax a corporation the same as a partnership would be to tax it out of existence.* In the partnership the individual pays the regular income tax and he will continue in business as long as there is a commensurate profit to the time and capital employed. The stockholder looks at the ownership which will give him the largest return, which must be more than just a marginal return.

The reasoning now in support of greater taxes in corporations is the result of the studies that have been made in relation to the corporation's ability to pay. "It is apparent that if we can combine a tax based on ability to pay with increased reliance for revenues upon that class of corporations whose income is most stable, and decrease our reliance for revenues upon those corporations whose income shows the greatest fluctuations, we move in the direction of stabilizing the revenues and evening our fluctuations."** This statement made in 1935 was in support of a graduated

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*See appendix

**Testimony before the Senate Finance Committee, August 6 and 7, 1935, by Robert H. Jackson. Quoted in "Taxation and Public Policy", edited by Paul Studenski (1936) P. 228.

tax up to 16 3/4 per cent as a normal tax with no regard to a surtax. However, the results of this study may later be seen as the cause of a greater tax on corporations when the Federal Government was seeking new sources of revenue.

(2) Surtax on Undistributed Profits

The legislation of this tax was made for the purpose of obtaining larger revenues and also for the imposition of the tax burden upon small corporations as well as non-corporate forms of enterprise.

Since the processing taxes had been declared unconstitutional and there was revenue needed to pay for the adjusted-service certificates, the government believed that this tax would supply the needed revenue. Another feature of the undistributed profits was that corporations retained their profits rather than distributed them in the form of dividends so that the stockholders would not be subject to the high surtax rate of the individual income tax.

From the enactment of this law corporations have criticized its effects. Here are given some of the possible defects of the law:

"1. A high-rate undistributed profits tax would punish corporations for accumulating surpluses to supply necessary capital, pay regular dividends, and meet other contingencies.

2. It would increase business instability by coercing corporations to pay out funds which should be saved for future needs. Corporations would lack reserves to sustain themselves during depressions and might be forced into bankruptcy. Dividend payments would be less regular because they would be increased during prosperity and decreased during depression.

3. An undistributed profits tax would rest most heavily on the young growing corporations which raise their capital primarily by reinvested earnings. Since existing surpluses would not be taxed, corporations with sizable reserves would possess substantial advantages over corporations with reserves depleted during depression.

4. The new tax would cause the government to interfere with corporation policies and to exercise considerable control over corporation saving. The management of a corporation, it was argued, is in a better position than the government to decide what part of the earnings shall be paid out as dividends.

5. The undistributed profits tax is an untried revenue which England and other leading nations have rejected. It could not be foretold how much revenue the new tax would yield because of the inability to forecast what portion of corporation profits would be paid out as dividends. The administration was criticized for favoring such a controversial measure without carefully investigating its history and its possible effects.

6. The undistributed profits tax would tend to increase immediate revenues because of the heavier taxation of corporation earnings, but it would tend to decrease future revenues by retarding corporation expansion and curtailing dividends during depressions. Income tax receipts would become more unstable because of the greater irregularity of dividends.

7. The new tax would be more complex than the existing corporation profits tax and would be harder to compute.

8. The primary motive for setting aside reserves is not to avoid the surtax but to meet future capital requirements. The great majority of corporations, which do not accumulate reserves to avoid surtaxes, should not be punished because of the behavior of the small minority which practice tax avoidance.

9. Finally, the government should cut expenditures rather than increase taxes."*

Corporations hope that this law will be changed but if it is not there is no other direction than that of adjusting themselves to the law. Dun and Bradstreet's Review suggest

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*Alfred G. Buehler, "Public Finance" (1936) P. 391.

in a survey made that 20 per cent of the corporations intend to distribute dividends in other than cash. This is permissable by law and corporations will take every advantage possible. Since the profits are taxed if they are not distributed, and if distributed they are taxed to the shareholder, therefore, some of the corporations have increased wages and salaries and advertising expenditures to be deducted as operating expenses rather than show a large profit.*

In the matter of distributing taxable dividends there may be a tax-saving device to the shareholder. This is the question whether or not he pays a higher tax in the form of an income tax for those dividends received or whether or not the corporation pays a higher tax in retaining the profits.

As to the future of this law it seems evident that the situation of the smaller corporations must be changed. President Roosevelt stated when this law was being considered that many small business organizations were incorporated to escape the individual income tax, and part of the function of the undistributed profits was to help correct this evil but it has not worked out very well in practice.

If this law is changed these small corporations may again have an advantage. To try and lessen the discrimination against some corporations may leave loopholes which can be utilized by others. The situation now is that small cor-

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*The United States News, October 4, 1937.

porations seeking to gain a firm foundation and retire a debt are burdened because of the action by those corporations who are trying to evade taxes.

W.L. Crum has made a study of corporations distributing their earnings and it indicates the position of the smaller corporation:

Percentage of Distribution*

1931-1933

Assets (Thousands of Dollars)	Percentages 1931	1932	1933
0 to 50	41	54	31
50 to 100	49	61	29
100 to 250	56	60	33
250 to 500	62	63	33
500 to 1,000	67	65	38
1,000 to 5,000	71	70	46
5,000 to 10,000	78	78	53
10,000 to 50,000	81	82	69
50,000 & over	95	98	91

This is probably not a fair period to show distributions of profits since the small corporations cannot build up a large surplus to be distributed in time of depression, and likewise, large corporations showed a bigger distribution in time of depression because their earnings were lower and they did not have to make a large distribution in order to increase their relative position of distribution to earn-

*W.L. Crum, from the United States Treasury Statistics of Income. This table was shown by Alfred G. Buehler in his book, "The Undistributed Profits Tax" (1937)

ings.

It must also be considered that the larger corporations distributing the greater percentage of profits in dividends have a better market for their securities when they wish to expand, and therefore, are not so dependent on their retained income. This is another purpose of the undistributed profits tax, that of making the corporations rely on the security market rather than on savings. However, in a study upon the contributions to capital it is stated that capital has come in the form of profits put back into the business, not through the sale of securities.*

Surtax on Undistributed Profits

7 per cent of the undistributed net income which is not in excess of 10 per cent of the adjusted net income.

12 per cent of the undistributed net income which is over 10 per cent but not over 20 per cent of the adjusted net income.

17 per cent of the undistributed net income which is over 20 per cent but not over 40 per cent of the adjusted net income.

22 per cent of the undistributed net income which is over 40 per cent but not over 60 per cent of the adjusted net income.

27 per cent of the undistributed net income which is in excess of 60 per cent of the adjusted net income.

(Adjusted net income is found by subtracting from net income the normal corporation profits tax and certain credits for interest on obligations of the government and its corporations, for affiliates of bank holding companies, and for national mortgage associations. Undistributed net income is the adjusted net income minus dividends paid and credits arising from contracts which restrict dividend payment).

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*Carl Snyder, "The Capital Supply and National Well-Being", American Economic Review, January, 1936.

EXCESS PROFITS TAX

Tax Rate

6 per cent of the net income which is in excess of 10 per cent and not in excess of 15 per cent of the adjusted declared value of the capital stock.

12 per cent of the net income which is in excess of 15 per cent of the adjusted declared value of the capital stock.

This tax was introduced in 1933 along with the capital stock tax. Because it has been an administrative burden it was considered that it should be one of the first taxes to be struck from our tax system. First, when the budget was balanced it would be dropped, then from the expected returns of liquor taxes it was to be repealed, and lastly, the undistributed profits tax was to replace this tax along with the capital stock tax. The tax is still in our system since it is needed in spite of the small revenue that is obtained.

"There is an obvious element of unreality in the excess profits tax as it was restored in 1933. It measures excess profit on the basis of the adjusted declared value of the capital stock rather than on the value of the invested capital. No criteria are provided for the determination of the capital stock value with a view to securing correspondence with the capital investment. In consequence, capital stock valuation need have no relation whatever to the value of the assets. The concept of an excess profit can have none but a purely artificial and arbitrary meaning unless

it is related to and based upon the capital investment that is producing the return. Such a basis is entirely rejected in favor of reliance upon the capital stock tax to prevent stock valuations from being unduly inflated."*

TAXATION OF PERSONAL HOLDING COMPANIES

Surtax upon Personal Holding Companies

Undistributed Adjusted Net Income	Rate %
0 -- 2,000	8
2,000 -- 100,000	18
100,000 -- 500,000	28
500,000 -- 1,000,000	38
Over -- 1,000,000	48

The surtax on personal holding companies came into being with the Revenue Act of 1934 and has carried over until the present 1937 act. Its purpose was to stop some of the avoidance by people unwilling to pay the high surtax on their incomes. There are two qualifications that the law states and upon which qualifications a corporation is a personal holding company or it is not. Before 1937 any corporation was a personal holding company which received at least 80 per cent of its gross income from royalties, dividends, interest, annuities, and gains from the sale of securities (except in case of security dealers), and having, at any time during the last half of the taxable year, more

*Harley L. Lutz, "Public Finance" (1936) P. 623.

than 50 per cent of its outstanding stock owned by not more than five individuals.

Reform--Prevention of Evasion

This tax was not introduced as a revenue measure but as a form of regulation. Usually in the case of reform when it is not in favor with the group upon which it is imposed it must go to the extreme. This has been true of the high surtax rate on the income of individuals. To prevent people with large incomes from incorporating to save taxes the rates upon the personal holding company have become excessive. Under the 1937 law the rates are as follows: On the first $2,000 of the undistributed adjusted net income--65 per cent; and on the remainder of such income--75 per cent.

The 1937 law should not be considered in this study but it is brought into illustrate the increasing administration which is required to enforce our tax laws.

"Personal holding companies are no longer advisable, except for persons of small income. There is against such type of corporation the 8% to 15% income tax, the capital stock tax, the 6% or 12% excess profits tax and the new 65% to 75% holding company tax for non-distribution added to the usual undistributed profits tax of 7% to 27%. The last two taxes are avoided, naturally, by distribution of the income in the form of taxable dividends to the share-

holder. Where the latter are in small surtax brackets, there is enough saving to warrant distribution, thus leaving such type of company open to only to the usual corporate taxes."*

THE CONDITION UNDER THE LAW IN REGARD TO GAINS AND LOSSES ON CAPITAL ASSETS

Capital assets include all property other than inventory or stock in trade which the taxpayer sells in the usual course of his business. The 1932 act provided the deduction of losses on securities up to the amount of the gains if the securities were held two years or less. In the 1934 act the taxpayer other than a corporation is allowed the following percentages on gains or losses of capital assets:

Percentage	Period Asset Was Held
100	One year or less.
80	Over one year but not over two.
60	Over two years but not over five.
40	Over five years but not over ten.
30	Over ten years.

Losses are allowable in excess of $2,000 of the gains, this amount to be deductible from other income.

In a period of low income where the loss is likely to be greater than the gain, the taxpayer is limited in that he must carry the weight of the losses along with taxes which cannot be adjusted to such losses. In a period of gains he must pay the high surtax rate. He may sell stock at a loss at the end of the year to offset his gains but

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*"Alexander Federal Tax Course", Alexander Publishing Company, Inc. (1937) P. 432.

this is not practicable when capital asset values are high, and the "wash sale" provisions lessen the likelihood of his gaining on a transaction to sell and then repurchase the asset.

The attitude of the individual toward investment or speculation will determine his judgment whether or not this legislation is upon sound principles of taxation. The requirement that losses cannot be taken in excess of a certain amount makes the speculator more hesitant when the risk is greater, and also, the allowance that the longer the asset is held the gain recognized will be less, make for investment rather than speculation. We may think in the specific term of our security market--If speculation is a part of our industrial system there is no basis for an over-all tax which punishes the entire group for the conduct of some of the members of that group.

ESTATE TAXES

Rate of Tax from 1926 to 1935*

Net Estate after Exemption			1926	1932	1934	1935
			(In Percentages)			
0	--	10,000	1	1	1	2
10,000	--	20,000	1	2	2	4
20,000	--	30,000	1	3	3	6
30,000	--	40,000	1	4	4	8
40,000	--	50,000	1	5	5	10
50,000	--	70,000	2	7	7	12
70,000	--	100,000	2	7	9	14
100,000	--	200,000	3	9	12	17

--Continued on Page 62--

Net Estate after Exemption			1926	1932	1934	1935
			(In Percentages)			
200,000	--	400,000	4	11	16	20
400,000	--	600,000	5	13	19	23
600,000	--	800,000	6	15	22	26
800,000	--	1,000,000	7	17	25	29
1,000,000	--	1,500,000	8	19	28	32
1,500,000	--	2,000,000	9	21	31	35
2,000,000	--	2,500,000	10	23	34	38
2,500,000	--	3,000,000	11	25	37	41
3,000,000	--	3,500,000	12	27	40	44
3,500,000	--	4,000,000	13	29	43	47
4,000,000	--	4,500,000	14	31	46	50
4,500,000	--	5,000,000	14	33	48	53
5,000,000	--	6,000,000	15	35	50	56
6,000,000	--	7,000,000	16	37	52	59
7,000,000	--	8,000,000	17	39	54	61
8,000,000	--	9,000,000	18	41	56	63
9,000,000	--	10,000,000	19	43	58	65
10,000,000	--	20,000,000	20	45	60	67
20,000,000	--	50,000,000	20	45	60	69
Over	--	50,000,000	20	45	60	70

(Exemption for 1935 and 1936 is $40,000).

The table shows the rapid increase of the rates on estates after the 1932 Revenue Act. In 1926 the estate was allowed a credit of 80 per cent for all estate taxes paid to the state. Since it was a time of an availability of funds in the Federal treasury the credit could be given, but later when there was a scarcity of revenue such revenue was sought in the form of higher taxes on estates with no corresponding increase in the credit given for state taxes.

The large concentration of wealth is given as the reason for the higher limits of this tax; that there is not only

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*Summary of the Revenue Act of 1936, a pamphlet of the Old Colony Trust Company--Boston, Massachusetts.

a source of revenue here but these vast fortunes are not used to the degree that they would be if they were more evenly distributed. With the enforcement of our estate tax and gift tax which take a large proportion from the estate it is evident that there is a rapid change taking place. "Up to 1932 an estate of $80,000,000 paid a tax of $14,000,000. After 1932 the tax was $35,000,000; after 1934 it was $46,000,000; since 1935 it has been $60,000,000."*

GIFT TAX

This tax was introduced as a method of enforcing the estate tax. Since 1932 the graduated rate has been increased in the highest bracket from $33\frac{1}{2}$ per cent to 45 per cent in 1934, and from that rate to $52\frac{1}{2}$ per cent in 1935. There is also a $40,000 exemption in this tax.

The high rates of the gift tax are said to have discouraged the avoidance of the surtax of the personal income tax by splitting up income into trusts or otherwise. The tax is criticized for inviting the avoidance of the higher rate estate tax by giving away estates before death and is denounced as a tax which would be unnecessary if the estate tax rates were moderate. Those who oppose the tax say it cannot be enforced strictly, that a gift tax is unnecessary to reach large gifts because their income can be taxed by the income tax, and that the distribution of property over a period of years before death will greatly reduce the tax

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*The Boston Globe, June 6, 1937.

anyway. But Congress is determined to enforce the tax to prevent avoidance of the estate tax. With the exception of the unusually high collections in 1935, the yield of the gift tax has been so small that it hardly justifies its enforcement. The high rates of the income tax and the estate tax, however, will encourage the making of gifts and tend to increase receipts from the gift tax, because wealthy persons will seek to avoid as much of the heavy income and estate taxation as possible.

MISCELLANEOUS TAXES

(1) Capital Stock Tax

This tax, as was stated, was introduced with the excess profits tax in 1933. No corporation could declare a value which was fictitious without bearing one of the two taxes. If its capitalization was too high it paid a high capital stock tax and if it was low it paid a higher excess profits tax. This was the theory but during the depression corporations did not earn excessive profits and as a result there was a poor return for this tax.

Receipts from the Excess Profits and Capital Stock Tax*
(000 omitted)

	1934	1935	1936
Excess Profits Tax	$ 2,630	$ 6,560	$14,509
Capital Stock Tax	80,168	91,508	94,942

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*From the annual reports of the Secretary of the Treasury

The rate is $1 for each $1,000 of the adjusted declared value of the capital stock of a domestic corporation. For every foreign corporation doing business in the United States the tax is at the rate of $1 for each $1,000 of the adjusted declared value of capital employed in the transaction of its business in the United States.*

(2) Excise Taxes

The Principle of Indirect Taxation

The direct tax is one that is imposed upon a taxpayer with the incidence remaining upon him. When we think of an indirect tax it is one that does not necessarily rest upon the person who first comes in contact with it but it is one that may be shifted. This tax has two uses, one as a tax and the other as a regulator of production and distribution. However, it always appears as a tax, and later as a means of regulation. There is sound reasoning brought into being when the fact is stressed that an excise tax should be brought into being or raised to prevent or lessen undesirable production, such as, oleomargarine, alcoholic beverages, tobacco, and types of luxuries.

If there is pressure for revenue the scope of excise taxes are enlarged. Our Federal excise taxes have not entered into goods which are necessities but it is a prospect. In 1932 the sales tax was discussed as a possibility. The

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*"Alexander Federal Tax Course", Alexander Publishing Company, Inc. (1937) P. 445.

majority of people pay no Federal tax in any form, except when they use some commodity that is considered a semi-luxury or luxury. But if there were a sales tax it would be a tax which the consumer would bear.

The Period from 1929 to 1936

In 1929 there was the repeal of the excise tax on automobiles and reduced exemption of admissions. The tax on tobacco and documentary stamps increased in 1930 caused the returns of these taxes to be fairly constant. In 1931 and 1932 there was a decline because the revenues on these two items decreased.

The Revenue Act of 1932 did not take effect until 1933 so such revenues affected the fiscal year of 1933 instead of 1932. The taxes of this act were on lubricating oils, automobiles and parts, toilet goods, jewelry, radios, mechanical refrigerators, sporting goods, cameras, matches, chewing gum, soft drinks, candy, electric energy, and gasoline. Also taxes were imposed on certain imported commodities. The miscellaneous group included taxes on telegraph, telephone, cable, and radio messages, admissions, issues and transfer of bonds and stocks, deeds, sales of produce for future delivery, transportation of oil by pipe line, safe deposit boxes, checks, and boats.

No mention is made of the processing taxes of 1933 because they were special taxes.

The 1934 act included a tax on importation of fish, the processing of vegetable oils, sale of crude petroleum, processing and refining of crude petroleum, the processing and refining of gas from natural gas, transfer of firearms, an excise tax on dividends which lasted for six months, and also a tax on transfer of silver bullion.

In 1935 there was a reduction of the tax on gas and repeal of the tax on checks which had some effect on the returns, but this was counter-balanced by the fact that this was the first full year that taxes were assessed on alcoholic beverages due to repeal. Revenues continued to increase through 1935 and 1936. In the latter year excise tax returns were exceptionally good because of business conditions. There were increases in returns on alcoholic beverages, tobacco, manufacturers' excise tax, and issue and transfer of securities.*

CUSTOMS

Custom Receipts**

1928	$569,000,000
1929	602,820,156
1930	587,000,000
1931	378,300,000
1932	327,700,000
1933	250,800,000
1934	313,434,000
1935	343,353,000
1936	386,812,000

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*This material was taken from the annual reports of the Secretary of the Treasury.
**Ibid.

During this period where foreign trade was reduced to a low level our custom receipts reached the lowest level in 1933 that they have since the World War. Tariff policies have been completely changed, whereas we raised the tariff in 1930 the practice since the spring of 1935 has been to make for modification through reciprocal trade treaties.

In 1928 the receipts of customs fell from the high level of 1926 and 1927. This reduction was due chiefly to smaller imports of sugar cane and manufactured tobacco. 1929 was a year of continued business progress and revenues were increased almost to the all time high. With 1930 came the Hawley-Smoot Tariff Bill, but this bill did not have any effect upon the 1930 receipts. By 1931 the value of imports was falling off, however, the specific duties on many of the commodities tended to hold custom receipts more constant than fluctuating with prices. The value of imports fell off about 10 per cent while duties dropped only 2½ per cent from the 1929 level. Foreign trade decreased and duties would have been lower than they actually were in 1931 had it not been for the increase of imports caused by pending legislation which would affect those imports if they came in at a later date. 1932 was a year of greater decrease in vólume and value of imports, and 1933 was the low with $250,800,000 in receipts on customs.

The repeal of the eighteenth amendment increased customs on imports of distilled and fermented liquors. There were increases in imports and also the value of imports increased in 1934. In anticipation of a reciprocal trade agreement with Cuba increases in further receipts were limited by this action causing a reduction of imports. Larger collections in 1935 were the result of duties on wines and liquors, and due to the drought in the summer of 1934 there were larger imports of agricultural products. Increases in 1936 were normal increases in spite of small decreases on commodities caused by reciprocal trade treaties.*

SOCIAL SECURITY TAXES

The provisions of the Social Security Act include old-age assistance, the administration of unemployment compensation, aid to dependent children, maternal and child health services, services for crippled children, child-welfare services, public health work, and aid to the blind. The Federal government has taken the initiative in emphasizing social insurance and aid to those who are in need. None of these functions, however, will be carried on without the participation of the state. The exception to this administration of activities is the old-age benefits which are set up under Title 2.

This legislation is a result of our inadequacy to meet the critical conditions when so many people were destitute.

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*Ibid.

The Federal Government had to take the responsibility of administering relief to the unemployed and to those who were in need. Now in the light of that experience it hopes to build up a reserve in times of prosperity so as to lessen these misfortunes which occur in depression.

In assisting people to plan for the future it has enlarged its administrative function in which phase it cannot contract, it must always enlarge its sphere. There are many people who do not come under the Social Security Act but the ultimate plan is to bring these people under the act.

The prospect in the future of delegating all Federal administration in the matter of social security to the states is not likely to happen in a system of states and municipalities which becomes more dependent upon it.

(1) Taxes for Old Age Benefits

In retirement of older workers there have been given three benefits which would tend to stabilize employment for our younger workers: First, employment opportunities will increase with the withdrawal of older workers from the labor market; second, promotions will be hastened by the retirement of the older workers; third, the financial burden of supporting elderly relatives will be considerably lightened.* The Federal Government accepts these reasons as valid for these benefits--necessity for security in old

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*Information Service Circular, Bureau of Federal Old-Age Benefits (1936)

age, and the advantages that may result to younger workers.

Upon what theory this tax is levied it is not too clear. The tax levied on the employer as an excise tax is a payment for the privilege of doing business. Corporations paying such a tax are paying upon a benefit principle but they are likewise paying other types of taxes for the same reason. All of our so-called taxes upon ability to pay have an element of benefit received from the government, and when governments cannot tax on the former theory they resort to the latter one. No government can continue to tax the employer on this latter theory without injuring business.

Security is regarded as an essential to a better standard of living and one cannot doubt the objectives of such legislation. But in looking at the source of revenue, it is a reservoir of our national well being as well as a reservoir of our tax system. While one tax may not be too great a burden, it is this tax along with all other taxes that must be considered as a whole.

The tax upon employees is supposedly an income tax. This cannot be considered as an income tax and in reality it is not even a tax. Each individual is making a payment in expectation for a return. Taxation is for the general welfare of the people and not for the benefit of only those who pay into the treasury.

(2) Taxes for Unemployment

This is a tax which is imposed only upon employers.

The states are allowed to set up their own system of unemployment compensation, providing, it is acceptable under the conditions of the Social Security Act.

Before the passage of this act states were unwilling to legislate a tax upon the industries within their boundaries because they did not want to put them at a disadvantage with industries of surrounding states. Since the national law has become effective it has become necessary to comply with its provisions. If they did not set up unemployment compensation they would be taxed with no resulting advantage.

All states have such laws now and they are allowed a maximum credit of 90 per cent of the Federal tax. No state is allowed to pay out of its reserve until after two years of accumulating its funds. Administration expenses are taken care of by the Federal government.

The reasons for unemployment compensation have been given, such as; partial defense against relief, stabilization of employment by building up a reserve to lessen the shock of unemployment, larger degree of economic security to the worker, lessen disastrous results of depression through loss of purchasing power.*

The basis for such taxation upon the employer has been stated under the discussion of taxes for old age.

(3) Problem of a Reserve

All money received in the unemployment fund shall be credited to the Unemployment Trust Fund by the Secretary

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*Informational Service Circular, Bureau of Unemployment Compensation (1936)

of the Treasury, and all money withdrawn shall be paid as compensation to those workers unemployed. Each state is able to withdraw as much as it pays into the fund.

However, the money received from the taxation for old-age benefits is not divisible by states or by employers, that is, it is received as any other form of revenue. Each year Congress makes appropriations equal to the payments for that year and also to set aside a sum to provide for the payments of the future on a reserve basis. Although legally separate the payments are based upon the revenue received by the taxation of employers and employees.

Setting up such an Old-Age Reserve Account has caused many criticisms. Economists agree that the Treasury may be the safest place for funds in time of stress but in times of prosperity it may be a place of leakage. Political expendiency comes before a sound basis for such a reserve. Because money is more easily obtainable in good times it will be a just cause for larger old-age benefits. There are many advocates for a pay-as-you-go plan, to only tax for present payments rather than building up for the future. The weakness of this plan is that in time of future depression there would be less ability to carry the payments since employment would be decreasing.

An illustration from past history shows how a government will spend when there are excess revenues, and it shows the

weakness of not building for future necessities: "By 1893 practically all the debt that could be called had been paid and the outstanding bonds that could not be called were selling at a premium. Even if more bonds could have been called it would have been unwise to do so since the outstanding issues were used as a backing for national bank notes, which at that time were an important part of the currency. Because of the impossibility of spending the government's income on debt reduction an extravagant program of expenditures was adopted. Unfortunately at that time the country fell into a deep depression." In 1893 the debt stood at $961 million and in 1899 it was $1,437 million.*

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*Paul F. Stewart and Rufus S. Tucker, "The National Debt and Government Credit". A publication of the Twentieth Century Fund, Inc. (1937)

Chapter 4

State Taxation

In looking at our means of obtaining revenue in state taxation, we have mainly relied upon the property tax which now under the scrutiny of economists is in its theoretical stage of change. Our legislation along with the limitations of some of our state constitutions have many years to go before they have some of the revisions now proposed.

Since 1930 there has been a growth of new taxes, such as, the personal income tax, general sales tax, and the chain store tax. Public opinion has turned from the idea that the property tax is the only just tax. Two reasons are the basis for such an idea: First, the inadequacy of revenue because of the loss of property values; second, the rapidly rising expenditures during the depression. There was also the weakness of administration and collection of taxes upon personal property that made the difficulties so great that the only course for state legislatures was in the direction of new tax laws.

Some of these new state laws have not been introduced with the sole purpose of balancing a depleted budget, their purpose being the same as that of the Federal government, that of regulation. In 1936 there were about twenty states who had adopted a plan of reform in chain store taxes. Most

of the plans have a graduated scale of taxing, making it impossible for one ownership to operate above a certain number of stores. Likewise, taxes taken as a whole sometimes are excessive, and it is almost mandatory that industry move to more favorable locations in regard to taxes. This problem has expressed itself in many industrial states. The taxed industry is constantly confronted with this irregularity when it tries to compete with the products of an untaxed industry in another state.

As one reviews the transition which has taken place in the last seven years there should be some consideration of the haste that new laws were enacted. Those that were passed as emergency measures and still remain to actually become laws may not be to the best welfare of our states in normal times. Only the process of testing will answer the question of whether or not this last period of our tax legislation has been conducive to better state government.

INTERDEPENDENCE OF FEDERAL, STATE AND LOCAL GOVERNMENT

Each form of government has a certain jurisdiction wherein it may tax, and as in our political boundaries it is true in our system of taxation that the basis of our state government depends upon each division of government remaining within the limits of its jurisdiction. The limitations of the taxing authorities are outlined as follows:

"Limitations on Power of Federal Government to Tax:

1. No tax or duty may be laid on articles from

any state.

2. Direct taxes, except taxes on income, must be apportioned among the states according to population.

3. Indirect taxes must be uniform.

4. There has been developed by implication the rule that the Federal Government may not tax the property, agencies, or instrumentalities of a state.

"Limitations on Power of State and Local Government to Tax:

1. The states may not levy import or export duties.

2. The states may not levy tonnage taxes without the consent of Congress. (Five of these limitations are general restrictions on state powers which apply incidentally to their tax powers).

3. Federal treaties are a part of the supreme law of the land.

4. The states may not pass laws impairing the obligations of contracts.

5. The citizens of each state are entitled to all privileges and immunities of citizens in the several states.

6. No state shall deprive any person of life, liberty, or property without due process of law.

7. No state shall deny to any person within its jurisdiction the equal protection of the laws.

8. The states may not tax property or instrumentalities of the Federal Government.

9. The states may not tax interstate commerce."*

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*William J. Shultz, "American Public Finance and Taxation" (1931) P. 261.

Local taxation is included under state taxation because under its jurisdiction county, district, and city governments are controlled by the state activities. Federal limitations applying to the state likewise apply to the local authorities. However, it must not be thought that the states restrict entirely the local taxing power.*

History has portrayed first the integration of our states into a federated union, next comes the local government being more dependent upon state government, and now the culmination is tending toward a more centralized government.

Examples of this trend are readily shown by the growing interdependence of the different governments. The Federal Government allows an estate 80 per cent credit for state taxes paid (the 80 per cent credit being based upon the rates prevailing in 1926). The state also gives a large proportion of the tax received back to the local authorities. Since 1931 some states have had to subsidize the educational systems of some of the less able districts.

State aid to local areas is not a growth of our depression period. One writer wrote upon the subventions by states in 1928, showing the full significance of the part the state was playing in local finance. "The outstanding reason for the return of all or a part of a state-administered tax to the local governments is that the larger part of these

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*Ibid.

taxes has replaced local taxes. The income tax in Massachusetts, New Hampshire, New York, and Wisconsin, e.g. replaces the local property tax on intangibles. Most of the corporation taxes returned to the local districts were, in origin, substitutes for local taxes on corporate stocks and bonds, and tangible personalty of corporations or corporate real estate. And motor-vehicle licenses have frequently taken place of the property tax on motor vehicles."*

The close relationship among the forms of government should be looked upon as integrated authorities rather than as separate units in taxation. For example, the statement that local revenue is 5 billion dollars will give one picture; 3.5 billion dollars for state revenue will give another; and 7 billion dollars for Federal revenue gives still another picture. Each authority taken separately is a misconception and every taxpayer paying to three different units realizes this.

GENERAL PROPERTY TAX

We have already mentioned the fact that our tax on property is taking new trends. There are some very definite weaknesses which seem to be so apparent that it is mere repetition to mention them further.

From the early Greek city-state down to the present we have had taxation upon both real and personal property. Because of land being man's greatest source of income it

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*Mabel Newcomer, "Tendencies in State and Local Finance", Political Science Quarterly, March, 1928. P. 19.

was looked upon as the source wherein governmental revenues should be obtained. Then along with land in later periods of history, man's personal property seemed to come into the sphere of taxation. Now in contemporary times, the past two decades, greater stress has been laid upon the subdivision of personal property--those of intangibles.

But in the face of weak administration, unqualified assessors, and ease of evasion we have had a program that was about to fall under the weight of its own defects. However, there has been a tendency to check these weaknesses. County equalization boards have had a renewed growth, and our state tax commissions are now employed more than they have ever been. So as a result, our administration of this tax has improved. Yet we still have an almost insurmountable task in a uniform tax on property--"there are several hundred thousand different tax-collecting jurisdictions in the United States. In addition to the federal government and the forty-eight state governments, there are more than 16,500 incorporated villages, towns, and cities, 127,000 school districts, 3,500 counties and thousands of township, town, and special districts."*

Richard T. Ely writes that reform in land taxation should first start in doing away with the tax assessment upon the selling price of land. Valuation should be based

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*Harley L. Lutz and William G. Carr, "Efficient Tax Administration", The Journal of the National Education Association May, 1934. P. 146.

upon the income returned. If there is no return in the form of income there should be no tax.* His claim that the high tax on agricultural land has prematurely brought such land into urban use is seen very easily in comments made in our newspapers by the New York City Comptroller. He expressed alarm over the influence of great public works, new tunnels, and bridges upon the taxpayer, who having easy access to the City could move to suburbs with lower rates. New Jersey, Connecticut, and New York State itself were looking to these prospective homebuyers. Boston is also in much the same situation; people having moved out to the surrounding suburbs, one of their reasons is because of taxation.

(1) Assessment

Total levies of the general property tax of states and all civil divisions under its jurisdiction were $5,026,763,000 during 1932; in 1922 they were $3,503,725,000; in 1912 they were $1,349,841,000.**

The following average assessment gives us an example of how industry has been a factor in changing taxation upon property. In the industrial states there was not so large an increase as in the agricultural states where the assessment tends to be on a decided increase. The best examples showing an increase are the West North Central States, South Atlantic States, West South Central States, and the Mountain States.

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*Richard T. Ely, "Recovery Program for a State", Review of Reviews, August, 1934. P. 62.
**Financial Statistics of State and Local Governments, Bureau of the Census--1932.

Average Tax Rate Per $100 of Assessed Valuation--
All Civil Divisions*

	1912	1922	1932
Total	$1.94	$2.81	$3.08
New England	1.69	2.64	2.87
Middle Atlantic	1.95	2.87	2.98
East North Central	1.88	2.84	3.12
West North Central	2.23	2.61	2.96
South Atlantic	1.57	2.21	2.54
East South Central	1.96	2.17	2.42
West South Central	1.65	3.08	3.90
Mountain	3.33	3.04	3.54
Pacific	2.30	4.50	4.18

(2) Tax Delinquencies

The problem of delinquencies is also the problem of tax assessment. In 1932 the general property tax levied was $5,026,763,000, and only $4,684,784,000 was collected as revenue.*

These tax delinquencies have steadily risen since 1928. Real estate delinquencies in 1536 counties were $26,736,000 in 1928, rose sharply to $67,964,000 in 1931, and reached their high point in 1932 with $70,115,000 worth of delinquencies.** Not being able to pay these taxes there is only one recourse for the owner, which is to sell the property. "The spectacle of homes and farms and forests in substantial volume passing out of the hands of their owners on account of delinquent taxes is evidence of a

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*Ibid.
**"Taxation and Public Policy", edited by Paul Studenski (1936) P. 72.

condition that seriously threatens the security of private property. Tax delinquency in large and increasing amount is therefore a phenomenon of serious significance both to government and to the owners of taxable property."*

ESTATE AND INHERITANCE TAX

The estate and inheritance tax of the states was largely influenced by the Federal government when in 1924 it adopted the law of allowing the states an offsetting credit up to 25 per cent for all taxes paid. For those states not having such a tax they were rather at a disadvantage. The Federal government taxed all estates uniformily but there was no tax returned to the states that did not provide for such a law. In 1926 there was a further increase of this credit up to 80 per cent. Now all states take advantage of this credit with the exception of Nevada.

There has been a good deal of controversy over this tax among the several states. It is not only characteristic of this tax, but the diversification of our state system of taxation is aptly illustrated under our present inheritance and estate tax laws. Our inheritance or death tax receipts upon tangible property supposedly go to the state wherein the owner had his residence, but in the case of intangible property it is taxed in the state wherein it is held. States very readily contest any judgment if they think

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*Fred Rogers Fairchild, "The Problem of Tax Delinquency", American Economic Review, March, 1934. P. 141.

they have a priority claim for taxation of such inheritance.

The states are somewhat uniform in taxing estates and inheritances. Alfred G. Buehler lists the following characteristics of the majority of states:

1. Legislation has been passed to secure the revenue allowed by the 80 per cent credit against the federal estate tax under the 1926 law.

2. Reciprocal agreements have been entered into in taxing the transfer of the personal property of non-resident decedents to secure more equitable and uniform taxation.

3. Gifts in anticipation of death are taxed.

4. Inheritance tax collections are used entirely by the state governments.*

State Inheritance Tax

Direct:

Graduated--42

Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia Washington, West Virginia, Wisconsin.

Flat--4

Nebraska, New Mexico, Pennsylvania, Wyoming.

Collateral:

Graduated--40

Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa,

--Continued on Page 85--

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*Alfred G. Buehler, "Public Finance" (1936) P. 324.

they have a uniformity claim for taxation of such intangibles.

The states are somewhat uniform in taxing estates and inheritances. Alfred G. Buehler lists the following characteristics of the majority of states:[1]

1. Legislation has been passed to secure the revenue allowed by the 80 per cent credit against the federal estate tax under the 1926 law.

2. Reciprocal agreements have been entered into in outline the domicile of the decedent property of non-resident decedents to secure more equitable and uniform taxation.

3. Gifts in contemplation of death are taxed.

4. Inheritance tax collections are made entirely by the state governments.

State Inheritance Tax

Digests

Beneficiary--41

Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin.

Flat--5

Nebraska, New Mexico, Pennsylvania, Wyoming.

Collaterals:

Graduated--41

Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa,

--Continued on page 185--

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[1] Alfred G. Buehler, "Public Finance" (1936) P. 474.

Kansas, Kentucky, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin.

Flat--7

Maryland, Nebraska, New Hampshire, New Mexico, Pennsylvania, Vermont, Wyoming.*

INCOME TAX

After 1913 when provision for a federal income tax was adopted some of the states introduced this method of taxation. Especially, were they conscious of the growing need of revenue when prohibition became effective and took away an important item in their taxation. In 1929 there was a further increase of states beginning to tax income.

States with Personal Income Tax

Graduated--24

Alabama, Arizona, Arkansas, Delaware, Georgia, Idaho, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, New Mexico, New York, North Carolina, North Dakota, Oklahoma, Oregon, South Carolina, South Dakota, Utah, Virginia, Wisconsin.

Flat--5

Indiana, Massachusetts, New Hampshire, Vermont, West Virginia.*

The state rates on income are very low, usually averaging from 1 to 6 per cent, while the Federal tax is fixed

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*Edward W. Carter, The Annals of the American Academy of Political and Social Science, September, 1935. P. 127.

with a normal tax of 4 per cent then the surtax is a graduated tax up to 75 per cent on incomes over $5,000,000. So in thinking of a state income tax we cannot think of them having any social significance such as in the Federal law. The purpose of the state income tax is that of obtaining revenue. Of the total local and state revenue received in 1932, $6,357,747,000, only $101,725,000 was due to revenue from the income tax.

CORPORATION INCOME TAX

Likewise, this tax under state jurisdiction has the purpose of that of the personal income tax. This state tax cannot be compared with Federal tax which includes the normal tax, the excess profits tax, the capital stock tax, and the undistributed profits tax.

This tax is a so-called franchise tax, for it is a grant from the state to conduct business with the basis of valuation for computing the tax upon income. Many states believe that a minimum tax should be imposed whether or not the corporation has earned sufficient income to justify a tax, some have the nominal sum of $10.

States with Corporate Income Tax

Graduated--7

Arizona, Idaho, Minnesota, Mississippi, Oklahoma, South Dakota, Wisconsin.

Flat--23

Alabama, Arkansas, California, Connecticut, Georgia, Indiana,

--Continued on Page 87--

Iowa, Kansas, Louisiana, Massachusetts, Missouri, Montana, New Mexico, New York, North Carolina, North Dakota, Oregon, South Carolina, Tennessee, Utah, Vermont, Virginia, West Virginia.*

CHAIN STORE TAXES

There were six chain store laws enacted before 1929 but this organization was not at that time thought of as one which required regulation. From our attitude against concentration of management as well as capital there has grown a strong opposition against chain stores. Twenty-two states at the present time have some form of legislation for chain stores.

These states differ in their method of taxation; some use the number of stores as a basis, others use total sales and merchandise inventory, average invested capital, purchases, then there are combinations of the different bases.

California has shown her reaction against such a tax while the legislature of Maine repealed an existing law. On the other hand, there have been an enormous number of tax bills introduced, which show the decided trend of opinion. The Supreme Court decision on the Louisiana chain store tax gave the states more freedom in legislating heavy taxes on chain stores which have inter-state relations. The Louisiana tax is upon gross receipts of the total number of stores.

COMMODITY TAXES

This includes only those excise taxes upon selected

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*Ibid.

commodities, the most important upon which the state usually assesses a tax are tobacco, gasoline, and liquor. They are an important part in the revenue of the state. In 1934 the state gasoline tax revenues were $565,000,000; the tobacco revenues were $24,000,000; liquor revenues were estimated at $106,000,000. Over one-half billion of dollars was realized from gasoline alone.*

There is a continued need for the maintenance of highways and they should gain the benefits of this gasoline tax, but it is being slowly diverted away from highways. Nebraska has added a one cent tax to gasoline for her social security program and other states find that there are more pressing needs than the maintenance of highways.

In tobacco taxation the Federal government tax is very high which makes it difficult for the states to tax. The revenue returned on this tax is not very large, but the tax on alcoholic beverages is very fertile. Besides these taxes there are taxes on amusements, playing cards, soft drinks, cement, cosmetics, and other commodities.

THE GENERAL SALES TAX

"In general, it means a tax based upon the receipts from the sale of the goods. As such, it should be distinguished from the taxes on commodities which are determined by some other standard than the sales receipt. Thus, the gasoline tax is not a sales tax. It is a specific com-

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*Alfred G. Buehler, "Public Finance" (1936) PP. 346-349.

modity tax, levied at fixed rates per gallon, regardless of the price."*

With the advent of the sales tax we have a tax that is very regressive. One in which we see in a period of rising prices resting upon the consumer. For awhile a sales tax was considered by the national government in 1932 but it was defeated. A tax that brings in large receipts, but it is one that requires a good deal of administration. It is also an unpopular tax, which does not make for an efficient tax system. There is no doubt it is not a good tax but the state legislators in dire need had no choice in the matter.

"The states could not greatly reduce their normal expenses without defaulting or seriously sacrificing standards in some extremely essential public services. Many states and their subdivisions have heavy fixed charges in the form of interest on debt, and over a thousand municipal units are, or have been, in default. Yet most of the primary functions of government, including education and highways, are their direct responsibility.

"Very few untapped resources of revenue were available to the states. Of these the most important were the state income tax and the general sales tax. The state income tax met with strong objection in the claim that 'you can't tax net income when there isn't any.' It was asserted to be

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*Harley L. Lutz and William G. Carr, "The Sales Tax", The Journal of the National Education Association, April, 1934. P. 110.

quite impossible, within the limits prescribed by administrative feasibility, interstate competition and the resistance of the taxpayer, to raise worthwhile sums from a net-income tax in some of the agricultural states like South Dakota. While only partially valid, these assertions carried weight. Moreover, the federal government was already in this field and the net-income tax encountered constitutionality in many states. Under these circumstances it is little wonder that new ground has been gained by the sales tax."*

The increase in sales tax is shown up to 1934:

States with General Sales Tax**

Year		No.
1934	Iowa, New Mexico	2
1933	Arizona, California, Illinois, Indiana, Michigan, Missouri, New York, Oklahoma, South Dakota, Utah, Vermont, Washington	12
1932	None	0
1931	North Carolina, Rhode Island	2
1930	Connecticut, Kentucky	2
Before 1930	West Virginia (Increased her rate), Minnesota, Wisconsin (chain), Louisiana, Delaware, Mississippi, Pennsylvania, Virginia	8

POLL TAX

The states levying poll taxes are California, Georgia, Indiana, Maine, Massachusetts, Texas, Vermont, Virginia, and West Virginia. This tax is assessed upon adults, but

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*Harold M. Groves, "A Tax Policy for the United States", The New Republic, February, 1934. P. 358.
**"Taxation and Public Policy", edited by Paul Studenski, (1936) P. 74.

because it is hard to assess many can easily evade it. Some states in taxing the residents do not allow them the privilege of voting without paying their poll tax. Others restrict issuing auto licenses before the poll tax is paid. Taxing at a definite source makes evasion impossible as shown in the two examples above. Still these sources are limited so that people could intentionally avoid the tax by doing without the privilege.* But the case of the poll tax is not serious since it comprises so little of state revenue, about 0.3 per cent of local and state revenue.

HISTORY OF STATE AND LOCAL DEBT

As early as 1820 the states began to borrow, and along with the looseness of government they tended to strain their borrowing power until 1837 when it collapsed with the depression. The western and southern states continued to borrow but they were stopped this time by the crisis of 1857. Both the North and South borrowed heavily during the Civil War, the South having to default on some of her outstanding issues after the war was over. Following the Civil War no more state financing was to be done on a large scale until the coming of the automobile. (After the South had regained somewhat of normal conditions the states begin to pay off their obligations).**

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*Arthur W. Bromage, "State Government and Administration in the United States", (1936) P. 397.
**William J. Shultz, "American Public Finance and Taxation" (1931) P. 123.

In writing upon state debt policy it is not necessarily a direct problem of the state authorities. It is an indirect problem, that of dealing with the municipal or local debt policy. After 1837 the states had seemingly learned their lesson, and by constitutional limitations had a control whereby there was little borrowing until the World War. While municipal indebtedness increased from $20,000,000 in 1840 to $300,000,000 in 1860, state indebtedness increased only from $200,000,000 to $250,000,000 during the same time. From the end of the World War to 1930 local indebtedness increased from $4,000,000,000 to more than $15,000,000,000, state indebtedness on the other hand increased from $350,000,000 to $1,750,000,000.*

The gross debt of states and local governments in 1932 was $19,576,412,000. Less sinking fund assets it was $17,576,839,000. Since 1912 we have seen this debt grow from $3,821,896,000 to its present size. It was during the war that state and local government started to expand. After the war there was a heavy flotation of bonds for highway purposes. The amount used for highways has been estimated at about half the total revenue for 1928. And during 1933-1934 the states were called upon to seek funds for relief expenditures. One authority says that because of the decline in the states' credit rating that in 1934 the bonds of only fifteen states were given a triple A rating by Moody.**

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*Paul Studenski, People's Money, January, 1937.
**"Taxation and Public Policy", edited by Paul Studenski (1936) P. 73.

During the depression state credit was far better than municipal credit, thousands of municipalities had to resort to default. In planning for a policy that makes for a more sound government, state and local, there are several principles which Paul Studenski points out: That of a pay as you go in good times while during bad times recovery could be facilitated by the expansion of state and local credit for capital outlays; the power to repudiate debts by state governments should be taken away; an intelligent accounting system of amortizing loans and planning maturities; effective budgets in planning their future capital outlays, and ways of financing; supervision by state of local borrowing; "state credit, wherever it is sound, should be employed during a future depression for the extension of loans to local governments whose credit is weak."*

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*Paul Studenski, People's Money, January, 1937.

Chapter 5

Social Control

THEORY OF GOVERNMENT CONTROLLING OR ACQUIRING INSTRUMENTS OF PRODUCTION

Government has entered into the domain of private enterprise for the last fifty years but in this last depression period there has been an assumption that government can eradicate all economic fluctuations. Some of the nations of the world are trying a huge experiment.

Control in these countries has been taken over largely by force. This is not true of those smaller countries of northern Europe having government control because they have developed a system through gradual growth rather than through any drastic measures. However, those countries where conditions were beyond the control of the contemporary government were the setting for some political figure to rise to power. These figures have realized that their only way of a controlled or planned society was to regiment the people with their allegiance to some mystical ideal--the state.

This is one type of control that can take place. The other type of control is through taxation; a government may levy such heavy taxes that industry will eventually revert to the government, or it can go into competition and through the money received from taxes purchase the units of industry. In the United States the government has control of the rail-

roads and other public utilities and also the security markets by commissions. Banking is controlled by our Federal Reserve Banks and credit agencies of the government. Agricultural control has been tried by subsidizing the farmer.

Control by government has become necessary but there are certain limits inside which it can make plans for a vast nation of people. The larger responsibilities cause a greater expenditure. Taxes must bring in a larger revenue but the amount of taxes is dependent upon the margin of our national income which is not needed. If the government needs to go beyond this margin it will lower our standard of living.* Many countries are needing greater revenues, and it becomes necessary to use strict measures. This finally leads to taking the actual necessities of the people. Many countries are finding it difficult to obtain revenue for the greater control which the government has assumed.

TAXATION AS AN INDIRECT SOURCE OF CONTROL

This is not thought of in the terms of an indirect tax, which is levied against a certain object or individuals but does not rest there. The term used here is the application of revenue, no matter from what source, to obtain control of the desired industry. The thesis considers the public utility industry, specifically the Tennessee Valley Authority, and agriculture under this subject.

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*Harley L. Lutz, "Public Finance" (1929) P. 23.

(1) Control of Public Utilities

The introduction of the Tennessee Valley Authority shows development of a different kind of government regulation. This organization was introduced as a regulatory measure and also as a stimulus to business, this latter reason being of minor importance.

Legislation previous to 1933 was not having any great degree of success, and the results which were shown took too much time for the amount of work accomplished. Savings in the field of electricity were not passed on to the consumer and this was thought to be of vital importance. So with this new act it should try to make regulation more efficient without being so cumbersome and there would be an instrument set up to measure the cost of the production of electricity.

"The power policy written into the Tennessee Valley Authority Act represents an attempt to regulate public utilities not by quasi-judicial commissions, but by competition. The act definitely puts the Federal Government into the business of rendering electric service. The Authority is required to acquire a market and to set up an area in which to conduct its operations. The results of these operations in this limited area are intended to serve as a "yardstick" by which to measure the fairness of the rates of private utilities, and to prevent destructive financial practices

by the latter."*

One writer compares the private utilities with the Tennessee Valley Authority in regard to a practical yardstick. "In the financial statements of the Tennessee Valley Authority not one cent is charged out for interest and depreciation, and the rate allowed for taxes is only a third of the average paid by private industries. Even if these factors were to be taken into account the yardstick would still be unrevealing, because only a small part of the total T.V.A. costs is allocated to electric power, and the rest to navigation and flood control......

"Private industry certainly cannot survive if it must compete with public industry subsidized by the taxpayer with an accounting system wholly different from its own."**

"The outstanding controversy regarding water power today is: Who shall develop and own it? There is a growing group which holds that power is such a vital necessity in industrial life that the state should control the development of the water powers and see that their product is distributed at the lowest economical price. This is especially true because of the public interest in the use of the power streams for other than power purposes. Most of the other stream developments must be controlled by the state and it is argued that complications might arise if water power were

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*David E. Lilienthal, "Business and Government in the Tennessee Valley", The Annals of the American Academy of Political and Social Science, March, 1934. Quoted in "Current Economic Problems", edited by Joseph B. Hubbard (1934) P. 668.
**Dorothy Thompson, editorial in the Boston Globe, November 11, 1937.

omitted from state control. On the other hand, all the classic arguments as to the inefficiency of most of the economic activities of government units are cited by opponents of state control."*

(2) Control of Agriculture

In Chapter 1. the history of agriculture since 1920 was briefly reviewed. During this period legislation was proposed and some measures were passed but their purpose was much different from the Agricultural Adjustment Administration. Distribution was the central theme not regulation or curtailment of growing crops. It was first thought that the foreign markets should be made to absorb surplus commodities, some of the ideas being to subsidize the farmer so that he would be able to produce under the conditions of a low price. Still later the government bought surplus crops with the hopes for a better market in the future.

None of these methods resulted as planned, however, the political power of the farmer made it evident that plans should be offered. As a part of the Farm Credit Administration in 1933 there was included the measure of regulation of production by paying the farmer for limiting his acreage. It was not compulsory but in the majority of cases the farmer found it necessary, the offer of credit was an advantage in itself to comply with crop restriction. The subsidy to the

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*Lester E. Klimm, Otis P. Starkey, and Norman F. Hall, "Introductory Economic Geography" (1937) P. 237.

farmers was to come from a processing tax which was to rest upon the urban population. The theory was to better the purchasing power of the farmer so that it would be on a parity with that of other groups.

The receipts of this processing tax totaled $969,258,000 from 1933 through March 31,1936. But the total expenditure for benefit payments alone, without administrative or other expenses, was $1,422,821,000. While in force these taxes yielded a large revenue, one year the revenues received were over $500 million. The taxes on cotton ginning and on sales of tobacco and potatoes are included in the above total; the revenue from these taxes was very small.*

This experiment in production control is continuing and will continue but is it the right cure? Taxes to keep unproductive land in use are not conducive to a higher standard of living. This planning is the central foundation of government regulation which tends to control price, and taxes levied for the benefit of one group may be to the detriment of the whole nation, not just the group being taxed, because of the adjustments arising from such planning.

Whoever estimates the balance between supply and demand will never have enough facts to judge without bias. Either the producer on the supply side or the consumer on the demand side are objects of this bias. "The law of supply

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*"Three Years of the Agricultural Adjustment Administration", a publication of the Institute of Economics of the Brookings Institution (1937) PP. 586-587.

and demand is the natural regulator of production and prices. Supply and demand tend to meet and satisfy each other. The law reaches out over the entire population offering everyone an inducement to do something that the people want done, with a scale of pay adjusted to their choice of wants. Food ranks first, but the price declines rapidly if everyone is assured of all the food he wants. People tend to get out of any business in which the pay is low, and into positions that pay better, which tends to keep the system in balance, provided no abnormal or artificial influence, such as a war or a law, shall interfere. If one farm crop brings a relatively low price, this may be corrected by shifting acreage to something else, but if the compensation for all farm products is low in comparison with the pay of other employments, there is no escape from the conclusion that too large a proportion of the population is engaged in farming."*

"Officials of the Department of Agriculture have said that 60 per cent of the present farm population would be able to produce all of the crops that the public desires, or is prepared to buy. It follows that 40 per cent is unneeded there, and simply divides the total compensation of farmers without increasing its purchasing power. They unbalance the economic system and lower its possible productiv-

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*The National City Bank Monthly Bulletin, January, 1938. P. 10.

ity as a whole. Evidently legislation which causes an unbalanced production of farm products is not a remedy for agricultural depression.......

"If the government subsidizes farmers to remain farmers when they are not needed, it will subsidize the surplus production which it wants to be rid of, and prevent the law of supply and demand from balancing the system."*

TAXATION AS DIRECT SOURCE OF CONTROL

As indirect control through taxation should not be confused with indirect taxation, likewise, direct control through taxation should not be confused with direct taxation. Control of trade through tariff is an indirect tax but its regulatory methods do not come from revenues received from customs appropriated to control trade, the imposition of the tax is the means of regulation. Besides control of international trade, control of corporate distributions and chain store regulation will be taken up under this subject. The latter being a problem of state control rather than Federal.

(1) Control of Trade through Tariff

Our tariff policies have had a decided effect in aiding those protected industries. Politically, we have tried to build up a philosophy of protecting our national interests. Pegging prices is another form of planned economy but we have not decried this form of control because it has been a benefit. Not only have our industrial interests received

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*Ibid., P. 11.

particular advantages, our agricultural interests have found tariffs to be advantageous.

Control of trade through tariffs has been used by the United States in the past but under the present Secretary of State there is the theory that our tariff policies should be international in scope rather than national. The Secretary of Agriculture views the cotton situation as one wherein it greatest menace is that the foreign countries do not have a means of exchange to buy the cotton of the United States. Professor James E. Boyle of Cornell University emphasizes this fact in contrast to a low price caused by a large surplus.*

The emphasis is now not on protection but upon getting nations to trade. This opposite policy may go to the extreme just as our tariffs have done. There is need for some regulation, because adjustments in international trade are sometimes rapid and detrimental if allowed to adjust themselves automatically. A basis for duties to protect beginning industries can be established but there is a doubtful basis for a duty which holds up a price.

Now in consideration of our present program, both national and international: There is a great difficulty in a planned economy where the advisors believe in a regulated economy within a country but they do not believe in it internationally. The margin of surplus which a country

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*The Boston Globe, September 5, 1937.

does not consume is supposedly put on the international market, the greater the surplus the more wealth a country produces. If this is true, a question comes up about the economy of the countries regulating production to reduce such a margin of surplus. When a country reduces its margin of surplus or its efficiency then it is handicapped in an international market.

(2) Control by Tax on Undistributed Profits

In a time of progressive taxation there is need to consider how taxpayers evade or avoid the higher income brackets. The analysis before 1936 showed that large corporations retained an amount which was rightfully the shareholders, and if a distribution were made in the form of taxable dividends then there would be greater tax receipts.

It was not only a means of receiving greater revenue in the form of individual income taxes or corporation income taxes (where the corporation retained such earnings) but it was also legislation which was to make the corporation more dependent on the security market. Corporations had speculated with their surplus funds or actually loaned their funds. They also were unwilling to spend such funds in a declining period where there was no prospect for a profit. For these two reasons surplus funds were looked upon as an unhealthy condition; they caused uncertainity by their lending, and second, if the financial condition

of a corporation were not so sound they would be unable to sit through a depression without borrowing money.

Many difficulties have arisen in connection with this tax. It has not brought in the expected revenue, and the situation in regard to being dependent on the security market has many complications brought about by the tax on gains and the limited credit allowed on losses of capital assets. This latter tax hinders the speculator when the odds are more heavily against him than ever in the risks that are involved. If the corporation must market its securities it must have buyers ready to buy.

The power of governmental control or regulation has been made very obvious through the undistributed profits tax. This tax has caused business to change some of its financial practices, and it has shown that it can determine to some extent the organization of business. The government has applied an abrupt method which may eradicate some of the evils but it has proved that it is not a means of control. So oppressive has this tax been that it has been a prohibitory measure instead of a regulatory one. The purpose of public control is to make for a greater benefit rather than hinder the industrial order.

(3) Control of Chain Stores

Arguments for either side of this question are not conclusive evidence of the good or evil of the chain store.

of a corporation were not so sound they would be unable to sail through a depression without borrowed money.

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(2) Control of Chain Stores

Arguments for either side of this question are not conclusive evidence of the good or evil of the chain store.

This type of organization has lent itself to many practices that are not compatible with an ethical way of doing business, however, they have added to the efficiency of management. Out of our technical progress it was clear that business organization was becoming more complicated. What methods could be applied so that there was some form of controlling a vast enterprise by management? Some products could be produced only on a large scale, and likewise, in its distribution it was found that it was more economical. No doubt there was and is a point beyond which large centralized control can operate effectively. The question then in its summary form is to what degree can business grow before it becomes top-heavy, and to what degree should government regulate this growth?

It is an arbitrary question and one if answered with authoritative legislation results in many injustices. The chain store tax is against growth rather than the unjust practices. If the problem is analyzed it can be shown that blanketed legislation includes those organizations which have given us many advantages, and although they are large, that is no reason for limitation of their activities or destruction of them.

Where these taxes have become excessive business organizations will have to liquidate or reorganize to meet legal qualifications so that they can avoid such taxes.

ECONOMIC ASPECT OF CONTROL

Our experiments whether or not with direct or indirect means of control through taxation have the same implications. To control public utilities, who would apply the yardstick and upon what basis? To control agricultural prices, who would determine an equitable price and amount of production? To control tariff policies, who would determine the amount of protection needed? To control corporations, who would determine its dividend policies? To control chain stores, who would determine unfair competition and the ability of chain stores to pay taxes?

Bejamin M. Anderson writes, "The thing would be turned over to practical administrators, chosen primarily with respect to their ability to get along with men and with respect to their acceptability to controlling political groups, and instead of economic planning we should get political compromise."* And Walter Lippmann, "The planner must know what men will produce and what they will consume: the only way to make sure of knowing this is to regiment men as producers and ration them as consumers. For you can confidently predict how men will behave only when you have power to order their behavior."**

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*Benjamin M. Anderson, "Planned Economy and a Planned Price Level", Chase Economic Bulletin, June, 1933. Quoted in "Current Economic Problems", edited by Joseph B. Hubbard (1934) P. 664.
**Walter Lippmann, Foreign Affairs, January, 1934. Quoted in Hubbard op. cit., P. 684.

These two statement were written in consideration of a fully planned economy and the part that economics will play. Our Federal Government may never assume the power of controlling millions of people but at present it is doing it to a certain degree because taxation has become a determinant in business. Private enterprise does not exist where its policies are determined by government. It may be a private enterprise as a legal entity but it is not one in fact.

WHAT WILL THE TRAFFIC BEAR?

Throughout this period in state taxation there has been a prominence of substituting different taxes for the old taxes. It usually results that there is no substitution but that there is an introduction of new taxes. The more tax laws make for greater administration, and as a rule they do not bring in the expected return. These new taxes may bring in revenue but they usually bring in added expenditures. Where a state was formerly satisfied to spend a certain amount of money, now with added revenue it must enlarge its sphere of government. The administration becomes very large and the tendency is for returns to be in smaller ratio to the amount spent.

In the Federal Government as taxes have become heavier they have had to make greater restrictions. The excess-profits tax and the capital stock tax had to be introduced together. To enforce the income tax there have been new

measures brought in, such as, the tax on personal holding companies, the tax provision on capital gains and losses, also on wash sales, and there is the undistributed profits tax. This legislation was not for revenue but it was to maintain the present tax structure. Peope do try to avoid taxes and moreso when they become higher.

We are in a period where the government cannot reduce its administration. There is a greater demand for revenue as this administration increases. In seeking sources the ultimate goal is to find sources enough to make income equal expenditure. Each source can render only so much, either because of economic law or political expediency.

Expenditures are flexible, at least in one direction, while tax receipts tend to have a limited capacity. Because we could expand our expenditures very readily in an emergency we thought in terms of one side of the equation; it was easy to borrow at low interest rates and it was just as easy to spend. Now in consideration of the other side of the equation; revenue raised by taxes is limited and above this limit people are unwilling to pay taxes. All of our government debt must be paid in taxes. There are ways to avoid paying this debt but the assumption is that it will be paid.

The basis for these taxes is upon what the government has spent whether or not it has received full value. Our

social philosophy has been relief for the masses and the system of taxation has changed tremendously to keep up with this philosophy. But it has not been able to keep pace, taxation is based upon what people can pay and not upon the amount that is required by expenditures.

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Page 10:

One cannot readily generalize on this problem of the ability of the farmer to pay off his mortgage, but a fair analysis can be given by showing the regions which hold these mortgages. The table would indicate that they are in doubtful farming areas, especially, those states in the west north central division where it is a one crop area.

Farm Mortgages Outstanding
January 1, 1930
(In Thousands of Dollars)

New England	144,744
Middle Atlantic	478,554
East North Central	1,890,811
West North Central	3,605,280
South Atlantic	508,927
East South Central	365,609
West South Central	904,940
Mountain	546,000
Pacific	796,525
Total	9,241,390

Land Values:

"The farm mortgage debt more than doubled between 1910 and 1920, but this increase was seemingly justified by the steady increase in land values throughout the decade. By 1920, however, land values had reached their peak and since that date have declined continuously. In 1932 land values for the country as a whole were 11 per cent below the 1913 figures, a drop of 17 per cent from the level of the pre-

ceding year. In the north central states, where the mortgage debt is most burdensome, land values are more than 20 per cent below the 1913 level."

The Purchasing Power of the Farmer:

"The deline in farm income is not attributable to any pronounced decrease in production, for the volume of net agricultural production has remained quite steady during the past decade. Farm prices at the close of 1932, however, were approximately one-half the 1913 level and one-quarter of the 1920 level, while the price of commodities the farmers purchase remained 6 per cent above pre-war prices. In other words mortgagors, as a group are now attempting to carry obligations two and one-half times the amount carried in 1910 (1910--$3,320,470 billion; 1930--$9,241,390 billion), but their crops and livestock bring them only 50 per cent of the pre-war prices. With this shrinkage in income, defaults on the part of a large number of mortgages are inevitable."

Debts in Relation to Values:

"In 1910 owner-operated farms were mortgaged for only 27.3 per cent of their market value and in 1920, at the peak of land prices, the ratio was 29.1 per cent. This ratio of debt to land values had increased to 46 per cent in 1928 but had declined in 1930 to 39.6 per cent, although

for the east north central and west north central states the ratios were 45.0 and 43.4 per cent respectively."*

Page 35:

The definition of real worth would be that of customary value. It would mean that a person could buy relatively the same thing for the same amount of money over a period of time. One must naturally take a viewpoint of that of a short period of time. This would be about the period of a cycle, where there would be minor fluctuations but no drastic changes in the price level.

Page 51:

There is a distinction between the ability of a corporation to pay taxes and that of the individual. Two quotations are given in explanation of such ability:

"The emphasis on corporate ability in defense of the graduated rates on corporations during the revision of the law in 1935 was an appeal to the popular prejudice against large business units. It revealed complete misapprehension of the nature of the ability concept, which is a personal attribute and cannot be an attribute of business as such. Nothing could be more uncertain than the proposition that the size of the business income is indicative of ability.

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*This summary is taken from "Internal Debts of the United States", edited by Evans Clark, The Twentieth Century Fund, Inc. (1933), The MacMillan Company, New York. PP. 29-31.

APPENDIX

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Page 201

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Page 211

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*This summary is taken from "The Internal Debts of the United States", edited by Evans Clark, The Twentieth Century Fund, Inc. (1933), The Macmillan Company, New York. PP. 423-31.

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Two corporations might each have a net income of $1,000,000, and according to the position taken in and out of Congress at the time, they would have equal ability to pay taxes based on net income. But in one case there might be five shareholders and in the other case 5,000. Greater disparity than this actually exists in the relative diffusion of stock ownership, so that no reliable inference regarding ability can be drawn from the size of the net income and any attempt to do so, expressed in heavy or graduated corporation tax rates, leads to severe discrimination against small stockholders."*

"The new federal policy of taxing corporations at progressive rates may produce more revenue, at least immediately, than taxation at flat rates but it is open to criticism on various grounds. (1) Business taxes are impersonal and the individual abilities of shareholders are disregarded in profits taxes. (2) Taxes at progressive rates penalize corporations simply because of their large incomes. Although the excess profits tax does consider the rate of return on investments, the ordinary profits tax is based on the amount of profits and not the rate of return on the investment. (3) The total income of corporations does not necessarily vary in proportion to the costs of the government services..."**

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*Harley L. Lutz, "Public Finance" (1936) P. 606.
**Alfred G. Buehler, "Public Finance" (1936) P. 386.

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DATE	ISSUED TO
6.40	E. D. Malione